2006/2007 : Report 6

OFFICE OF THE

Auditor General of British Columbia

Monitoring Government's Finances

Province of British Columbia

December 2006

2006/2007 : Report 6

OFFICE OF THE

Auditor General of British Columbia

Monitoring Government's Finances

Province of British Columbia

December 2006

Library and Archives Canada Cataloguing in Publication Data
British Columbia. Office of the Auditor General.
Monitoring Government's Finances

At head of title: Final report.

ISBN 0-7726-5535-9

1. British Columbia. Office of the Auditor General.
2. Finance, Public - British Columbia - Auditing.
3. Finance, Public - British Columbia - Accounting.
4. Administrative agencies - British Columbia - Auditing. 5. Government productivity - British Columbia - Evaluation. I. Title. II. Title: Final report : Monitoring Government's Finances.

HJ9921.Z9B74 2006 352.4'3909711 C2006-960064-3

OFFICE OF THE
Auditor General
of British Columbia

LOCATION:
8 Bastion Square
Victoria, British Columbia
V8V 1X4

OFFICE HOURS:
Monday to Friday
8:30 a.m. – 4:30 p.m.

TELEPHONE:
250 387-6803
Toll free through Enquiry BC at: 1 800 663-7867
In Vancouver dial 660-2421

FAX: 250 387-1230

E-MAIL: bcauditor@bcauditor.com

WEBSITE:
This report and others are available at our website which also contains further information about the Office: www.bcauditor.com

REPRODUCING:
Information presented here is the intellectual property of the Auditor General of British Columbia and is copyright protected in right of the Crown. We invite readers to reproduce any material, asking only that they credit our Office with authorship when any information, results or recommendations are used.

OFFICE OF THE
Auditor General
of British Columbia

2007-02212/

8 Bastion Square
Victoria, British Columbia
Canada V8V 1X4
Telephone: 250 387-6803
Facsimile: 250 387-1230
Website: http://bcauditor.com

The Honourable Bill Barisoff
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
V8V 1X4

Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2006/2007 Report 6: Monitoring Government's Finances.

Arn van Iersel, CGA
Auditor General (Acting)

Victoria, British Columbia
December 2006

copy: Mr. E. George MacMinn, Q.C.
Clerk of the Legislative Assembly

Table of Contents

Auditor General's (Acting) Comments 1

The Ongoing Evolution of Financial Reporting in British Columbia 3

Glossary 11

Part 1: Current Year Assessment 15

- Financial Statement Discussion and Analysis 17
- Our Financial Framework 18
  - Revenue Trends 20
  - Expense Trends 22
  - Surplus/Deficit Trends 24
  - Asset Trends 25
  - Liability Trends 28
  - Our Overall Analysis of Financial Measures and Trends 31
- Government Business Enterprises 33
  - Revenue and Expense 34
  - Assets and Liabilities 35
- CICA Indicators of Financial Condition 36

Part 2: British Columbia's Financial Condition Compared With Other Canadian Jurisdictions 39

Response from the Ministry of Finance 47

Appendices 51

- Appendix A: 2005/06 Public Accounts Overview – Financial Statement Discussion and Analysis Report 53
- Appendix B: Gross Domestic Product (GDP) per Capita 73
- Appendix C: Net Liabilities to Gross Domestic Product (GDP) 75
- Appendix D: Credit Ratings 77
- Appendix E: Office of the Auditor General: 2006/07 Reports Issued to Date 79

Acknowledgements

Audit Team

Assistant Auditor General:
Bill Gilhooly

Director:
Bob Faulkner

Project Leader:
Randy Nicholson

Audit Assistants:
Spencer Goodson
Heidi St. Denis
Kyle Thomson

Auditor General's (Acting) Comments

Arn van Iersel, CGA
Auditor General (Acting)

This is the fifth year my Office has published a report titled *Monitoring Government's Finances*. We published our first report in 2002, in part, to fill a need we saw for a clearer analysis and discussion of government's finances in the Public Accounts.

I was pleased to note that government has developed a more comprehensive financial statement discussion and analysis (FSD&A) section in the Public Accounts. The discussion of the province's financial results now has more depth and breadth than in prior years.

There is now a better explanation of how financial results differed from the previous year, additional descriptions of the nature of significant balances, and new trend analysis. Some of the key "Indicators of Government Financial Condition", as recommended by the Canadian Institute of Chartered Accountants (CICA), were also included and discussed this year.

I understand that the form and content of the FSD&A is still a work in progress, and recognize that some historical data is more readily available than others. Nevertheless, I believe that more development would be useful to readers, and encourage government to continue to make improvements in the FSD&A. One such example would be the inclusion of a longer time series.

After this year, my Office will review the need for continuing to report on government's financial health through this report, given government's improvements in the FSD&A, and expanded analysis in its Financial and Economic Review report. Notwithstanding the outcome of that review, we will continue to audit and express an opinion on the Public Accounts and make recommendations on how government could improve its financial reporting.

Auditor General's (Acting) Comments

I wish to thank everyone who cooperated with my Office and assisted us in gathering the information for this report. As well, I would like to acknowledge the hard work, professionalism and dedication of my staff in preparing this report.

Arn van Iersel, CGA
Auditor General (Acting)

Victoria, British Columbia
December 2006

The Ongoing Evolution of Financial Reporting in British Columbia

When we first started publishing our annual review, little public sector guidance on the form and content of this type of reporting was available. Therefore, to better explain its financial results to legislators and the public, we encouraged government in our 2002 report to: provide fully consolidated financial statements using the CICA's generally accepted accounting principles (GAAP); and supplement the financial statements with a good analysis and discussion of trends and key financial indicators.

To aid our analysis, we developed a financial framework based on the audited Summary Financial Statements of government. We believed that such a framework could assist government in better explaining its results. The framework included details of government business enterprises and the SUCH sector—not then found in government's financial statements—and provided a basis for discussing government finances in a way that was not done until 2006. We also advocated the use of the CICA's financial condition indicators noted above. These had been developed in a 1997 research study on government financial accountability.

In June 2004 there was a new development in public sector financial reporting standards. The Public Sector Accounting Board (PSAB) of the CICA published a "Statement of Recommended Practice" to aid governments in preparing a version of the private sector Management's Discussion and Analysis report. As had been done in the private sector for many years, the recommended practice called for management to provide a detailed discussion of its financial health and performance.

The Statement of Recommended Practice recommends that an FSD&A document should be prepared and published with the Summary Financial Statements, presenting:

- a summary of the significant events that affected the financial statements;
- a discussion of the significant risks and uncertainties underlying the financial statements; and
- an analysis of annual variances and trends.

British Columbia's Public Accounts document has included an FSD&A section in front of the audited Summary Financial Statements since 2004. In our past *Monitoring Government's Finances* reports, we have encouraged government to expand its use of the FSD&A, fully incorporating PSAB's principles. We were therefore

pleased this year when we saw that the FSD&A in the front of the 2006 Public Accounts was significantly expanded, and contained much of the material we recommended. We were also pleased to note that additional financial discussion and analysis was added to the Ministry of Finance's Financial and Economic Review report, which is published shortly after the Public Accounts.

We have recommended in the past that several key indicators of financial condition be reported by government to help explain its financial health. Some of these indicators are included in the 2006 Public Accounts (albeit as yet only on a three-year historical basis), and all of the indicators are now included in the Financial and Economic Review report for the past eight years.

We feel that including all the key indicators of government financial condition, and showing them for the past 10 years would provide readers with a more useful historical context of the past and the current condition of government's finances.

In some instances, we also found it difficult to find financial discussion and analysis material in the Financial and Economic Review report. In our view, including this material—together with all the key indicators in the FSD&A in the Public Accounts (which also includes the audited Summary Financial Statements) would be more beneficial than publishing them separately in the Financial and Economic Review report. Having all this information in one place would enable readers to see a more complete picture in a single document. We discuss this matter further in Part 1 of our report.

In 2005 government adopted generally accepted accounting principles (GAAP) for the preparation of its financial statements. This meant that considerable effort was required to ensure that both the Budget and the Summary Financial Statements were consistent with each other and compliant with GAAP. As well, additional effort was needed to ensure that previous years' comparative financial statements were restated to reflect the new rules.

Our New Reporting Model—This year we altered our reporting model. The detailed financial information framework (shown in Exhibit 3) no longer includes expanded financial information on government business enterprises. We have done this to make the report more readily comparable to the current Summary Financial Statements, and easier to read. The historical information has also

been restated to provide for consistency throughout the 10-year reporting timeframe.

However, government business enterprises have not disappeared from our report. Our analysis is in a new section in Part 1 (see "Government Business Enterprises" on page 33). To aid in comparing this year's report with prior years', our analysis of government business enterprises is compiled on the same basis. This makes the information about the enterprises consistent with the information presented in Exhibits 1 and 2 of our previous *Monitoring Government's Finances* reports.

This year's presentation is now consistent with Canadian GAAP. International public accounting standards require different recognition and disclosure of government business enterprises, however, this is what was provided previously. If and when Canadian standards-setters adopt the international standards the treatment of Government Business Enterprises in the Province's financial statements will need to be adjusted accordingly.

Current status of prior years' recommendations—In Part 1 of this report, we include our detailed analysis of the progress on the development of government's FSD&A section in the Public Accounts. We have also reached a milestone in this year's report in the collection and reporting of 10 years of comparative financial information. The financial information contained in this report is based on historical dollars sourced from the annual Summary Financial Statements and is not adjusted for inflation.

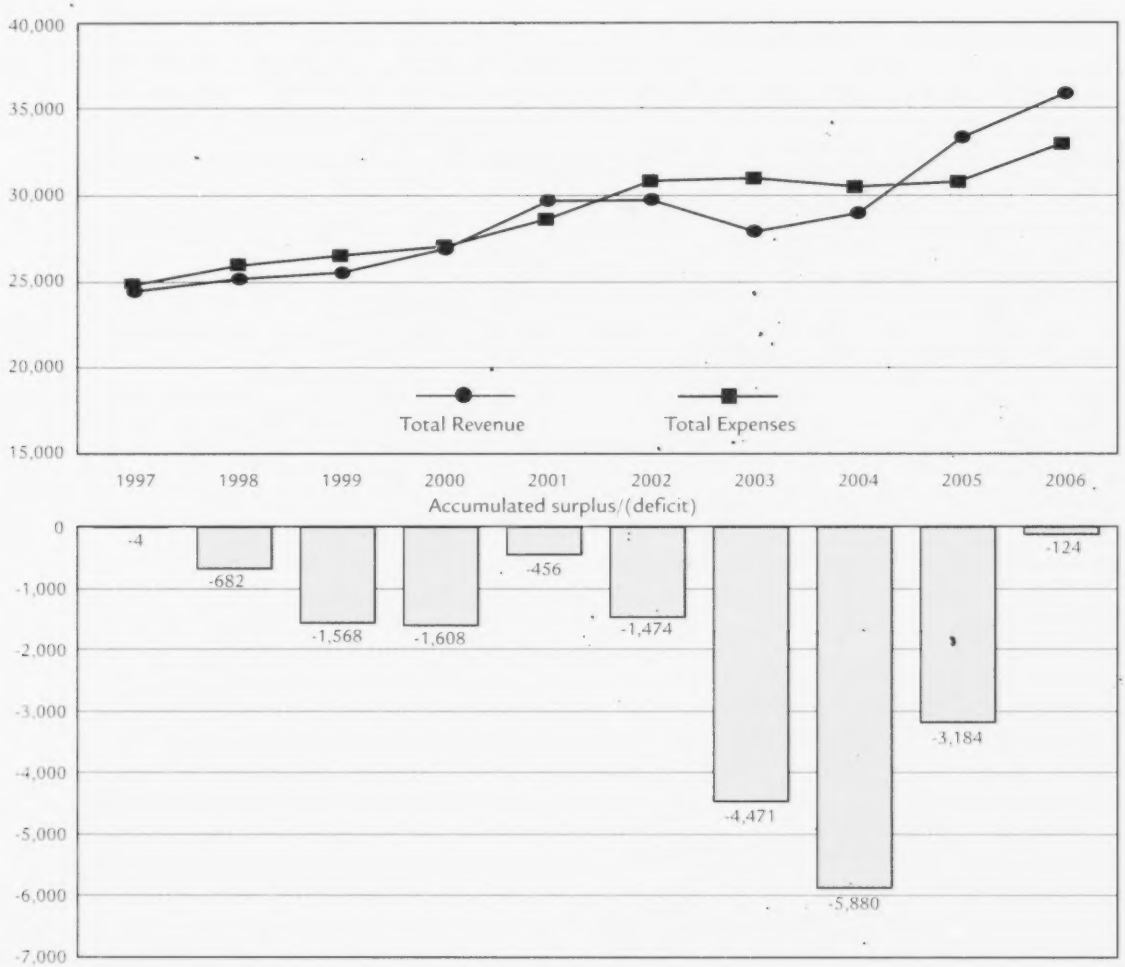
We have reduced our own financial analysis this year as a result of government's progress in improving its reporting on its financial condition. We hope that this progress continues.

The following two exhibits summarize the Province's ten-year trends for a few key financial measures. Exhibit 1 shows total revenues, expenses and accumulated deficit. Exhibit 2 summarizes financial assets, infrastructure assets, debt, other liabilities and net liabilities.

The Ongoing Evolution of Financial Reporting in British Columbia

Exhibit 1

Total Government Revenue, Expense and Accumulated Deficit
($ Millions)

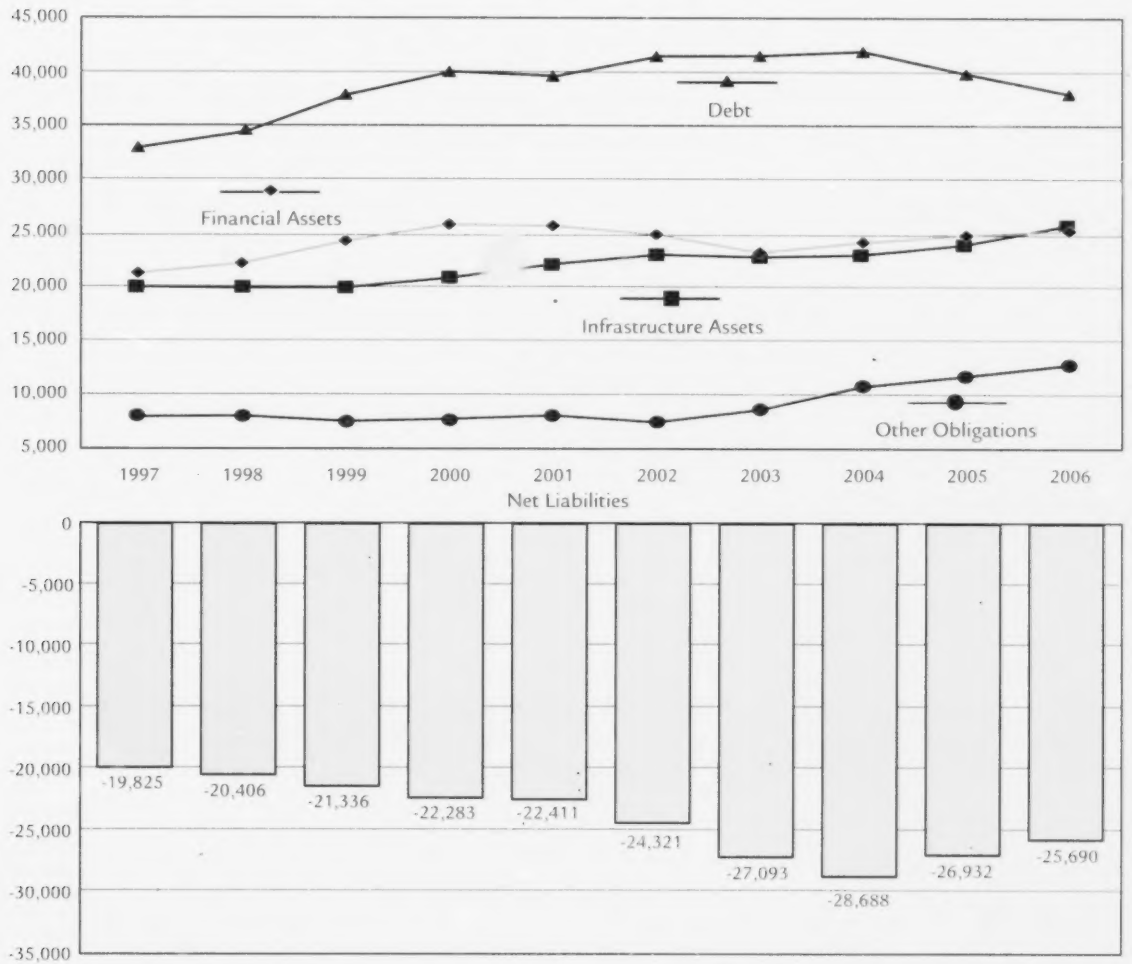


Source: Summary Financial Statements of the Government of the Province of British Columbia

Exhibit 2

Total Government Assets, Liabilities and Net Liabilities

Financial Assets, Infrastructure Assets, Debt, Other Liabilities and Net Liabilities ($ Millions)



Source: Summary Financial Statements of the Government of the Province of British Columbia

The Ongoing Evolution of Financial Reporting in British Columbia

Where we stand—Comparing British Columbia's financial performance with other provinces can be complicated. Economies, government responsibilities and structures differ from province to province. There may also be differing timing and applications of accounting standards. Further, comparing Provinces on the basis of a broad brush measure such as "GDP (Gross Domestic Product) per capita" has sometimes been criticized as an over-simplified approach. Finally costs of living and taxation policies may differ from province-to-province, making revenue streams difficult to compare.

Although such comparisons are not precise, they are still important because taxpayers and legislators want to know how we are doing relative to others. In Part 2 we therefore present a discussion of three common financial performance measures used for comparing British Columbia with other jurisdictions. We also discuss government's progress in reporting on these measures.

Recommendations

We make the following four recommendations:

1. *We recommend that government present a long-term trend analysis in the FSD&A, so that it can provide more context for discussing government's financial performance.*
2. *We recommend that government expand its FSD&A discussion of material financial risks and uncertainties and the challenges involved in their ongoing management.*
3. *We recommend that government include all relevant indicators of financial condition in its FSD&A, shown over an extended period, to supplement the existing discussion and analysis.*
4. *We recommend that government adopt the use of the CICA recommended measure of "government-to-government transfers to own-source revenue" for use in the FSD&A.*

Glossary

Glossary

Accumulated surplus/deficit	The total of all past annual surpluses and deficits to date.
Annual surplus/deficit	The difference between government's annual revenues and expenses.
BCCPI	British Columbia Consumer Price Index.
CICA	The Canadian Institute of Chartered Accountants.
Derivative contract	A "swap" or other financial instrument that is entered into with a third party, and is used to hedge interest rate, foreign currency or other risk exposures.
Federal transfers	Funds received by a province from the federal government, such as the Canada Health and Social Transfer (CHST) and Equalization payments.
Financial assets	Assets of government (such as cash, investments, loans and accounts receivable) that can be converted to cash in order to pay government's liabilities or finance its future operations. Financial assets also include government's investments in its business enterprises.
General infrastructure assets	Tangible physical assets used by government to provide general program services to citizens.
Generally accepted accounting principles (GAAP)	This refers to the accounting principles that government should follow in order to be consistent in its accounting practices with similar organizations. The authority for GAAP is the CICA.
General programs	Those activities of government that are supported by taxpayers.
Government business enterprises	Also known as commercial, self-supporting or modified equity enterprises. These are self-sufficient Crown corporations that sell goods or services to parties outside the government reporting entity.
Government reporting entity	The group of organizations that are consolidated in government's Summary Financial Statements.
Gross domestic product (GDP)	The money value of goods and services produced within a geographical boundary. It can be reported without adjusting for inflation (known as market value, current or nominal GDP) or it may be discounted for the effects of inflation (real GDP). In this report, GDP is not adjusted for inflation.

Glossary

Hedging	Reducing potential exposure to foreign currency, interest rate or other risks. Often achieved by entering into derivative contracts with a third party.
Net liabilities	A government's total liabilities less its financial assets. This is the residual liability amount that will have to be paid or financed by future taxpayers. Also referred to as "net debt."
PSAB	Public Sector Accounting Board of the CICA. This board recommends accounting principles for Canadian governments.
Public Accounts	Annual financial accountability document of the province. It includes the audited Summary Financial Statements and Provincial Debt Summary, the Financial Statement Discussion & Analysis, and other supplementary information.
Public debt	Borrowings of government. Debt generally consists of debentures, notes payable, capital leases and mortgages.
Public debt charges	Also known as the cost of borrowing, or debt servicing costs, this is the interest cost incurred by government on its borrowings.
Revenue-generating assets	The assets of government business enterprises. These are termed revenue-generating as the assets are used in the operations of self-supporting business enterprises.
SUCH sector	Refers to School districts, Universities, Colleges and Health authorities.
Summary Financial Statements	The consolidated financial statements through which government reports its financial position and operating results for the whole government reporting entity.

Part 1:
Current Year Assessment

Financial Statement Discussion and Analysis

In its Statement of Recommended Practice, the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) calls for the financial statement discussion and analysis of governments to:

- *Include financial statement discussion and analysis (FSD&A) in an annual report together with the Summary Financial Statements. The FSD&A should be referenced to the related Summary Financial Statements.*
- *Include an acknowledgment by government that it is responsible for the preparation and content of the information.*
- *Communicate information embodying the basic characteristics of financial statement information — understandability, relevance, reliability and validity, and comparability.*
- *Include a concise summary of the significant events affecting the financial statements.*
- *Include information on significant risks and uncertainties underlying the financial statements, and an outline of the strategies, policies and techniques adopted to manage them.*
- *Identify and explain significant annual variances. This could include year-to-year or budget-to-actual variances.*
- *Include an analysis of trends related to the elements of the financial statements. This could include a trend analysis of financial assets, liabilities, net liabilities, tangible capital assets, revenues, expenses, and cash flows.*

Last year we recommended that government expand its use of the FSD&A section in its Public Accounts. We also encouraged the use of the CICA "Indicators of Government Financial Condition" and other economic measures to provide a more complete context for the FSD&A. Such additional analysis is needed so that readers can more fully understand the major trends, indicators, risks and decisions that impact government's financial condition.

The spirit of our recommendations appear to have been met, and we acknowledge government's progress in developing an expanded version of its FSD&A. We still believe however that some additional development would be beneficial in further explaining government's financial position and overall financial condition. We discuss this in "Overall Analysis" on page 31.

The Public Accounts now includes an FSD&A that contains a fairly robust discussion of the results of operations of government. Included in a new section on financial performance, is a discussion of significant events that have affected the financial statements, as well as a more detailed analysis of the nature of significant transactions and annual variances. Three-year trends are presented relating to various components of revenue, expense, assets and liabilities. The FSD&A section also now contains a limited analysis of the CICA indicators of financial condition. Compared with prior years, there is also more discussion and analysis of the issues that affected financial performance.

Our Financial Framework

This year's report completes our development of a 10-year financial trend analysis framework. As noted above, we altered our financial framework this year. Exhibit 3 shows how we have restated the financial position and results to ensure that the information is presented in a manner more comparable with that in the Public Accounts. The key change is the removal of the detail on government business enterprises. However, to maintain consistency with prior years' Monitoring Government's Finances reports, we have included this detail in a separate section called "Government Business Enterprises" (page 33).

Because government has expanded its FSD&A, we have avoided duplicating the same material in our report. Instead, we focus mainly on matters we believe would benefit readers with additional discussion, such as an extended trend analysis and added contextual discussion on the nature of the financial information presented.

Exhibit 3 details 10 years of historical information (1997–2006) that supports our comments on measures and trends in this report.

Exhibit 3

Detailed Financial Information Framework, 1997 to 2006
($ Millions)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Revenue and Expense										
Revenue										
Taxation	13,463	13,551	13,620	13,796	14,329	14,136	12,331	13,830	14,917	16,429
Natural Resources	2,622	2,638	2,074	2,759	3,956	3,160	3,222	3,309	3,973	4,567
Federal Transfers	2,296	2,165	2,527	3,109	3,285	3,310	3,815	3,619	5,222	5,786
Other	6,025	6,768	7,280	7,214	8,095	7,634	8,514	8,208	9,251	9,165
Unusual Items	—	—	—	—	—	1,464	—	—	—	—
Total Revenue	24,406	25,122	25,501	26,878	29,665	29,704	27,882	28,966	33,363	35,947
Expense										
Health	7,456	7,820	8,102	8,683	9,291	10,414	11,036	11,197	11,529	12,822
Education	6,447	6,526	6,533	6,709	7,269	7,811	7,907	8,259	8,512	9,053
Social Services	3,099	3,181	3,146	3,115	3,263	3,442	3,145	2,819	2,598	2,798
Interest	2,247	2,184	2,751	2,976	2,996	2,777	2,544	2,425	2,294	2,182
Other	5,443	6,089	5,855	5,435	5,642	5,931	5,735	5,552	5,734	6,032
Unusual Items	—	—	—	—	52	347	512	123	—	—
Total Expenses	24,692	25,800	26,387	26,918	28,513	30,722	30,879	30,375	30,667	32,887
Surplus/(deficit)	(286)	(678)	(886)	(40)	1,152	(1,018)	(2,997)	(1,409)	2,696	3,060

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Assets and Liabilities										
Financial Assets	21,280	22,191	24,267	25,684	25,475	24,804	23,210	24,180	24,825	25,238
Liabilities	41,105	42,597	45,603	47,967	47,886	49,125	50,303	52,868	51,757	50,928
	(19,825)	(20,406)	(21,336)	(22,283)	(22,411)	(24,321)	(27,093)	(28,688)	(26,932)	(25,690)
General infrastructure assets	19,821	19,724	19,768	20,675	21,955	22,847	22,622	22,808	23,748	25,566
Accumulated surplus/(deficit)	(4)	(682)	(1,568)	(1,608)	(456)	(1,474)	(4,471)	(5,880)	(3,184)	(124)

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown corporation financial statements.

Note: Results in the above table have been derived from historical reporting, adjusted to ensure there is a comparable accounting based on current accounting standards.

Revenue Trends

Exhibit 4 shows the main components of government's revenue sources for the past 10 years and is the basis for the graph in Exhibit 5.

Exhibit 4

Government Revenue, 1997 to 2006

Government revenue by main source ($ Billions)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Taxation	13.5	13.6	13.6	13.8	14.3	14.1	12.3	13.8	14.9	16.4
Natural Resources	2.6	2.6	2.1	2.8	4.0	3.2	3.2	3.3	4.0	4.6
Federal Transfers	2.3	2.2	2.5	3.1	3.3	3.3	3.8	3.6	5.2	5.8
Other	6.0	6.8	7.3	7.2	8.1	9.1	8.5	8.2	9.3	9.2
Total	24.4	25.2	25.5	26.9	29.7	29.7	27.8	28.9	33.4	36.0

Source: Office of the Auditor General of British Columbia

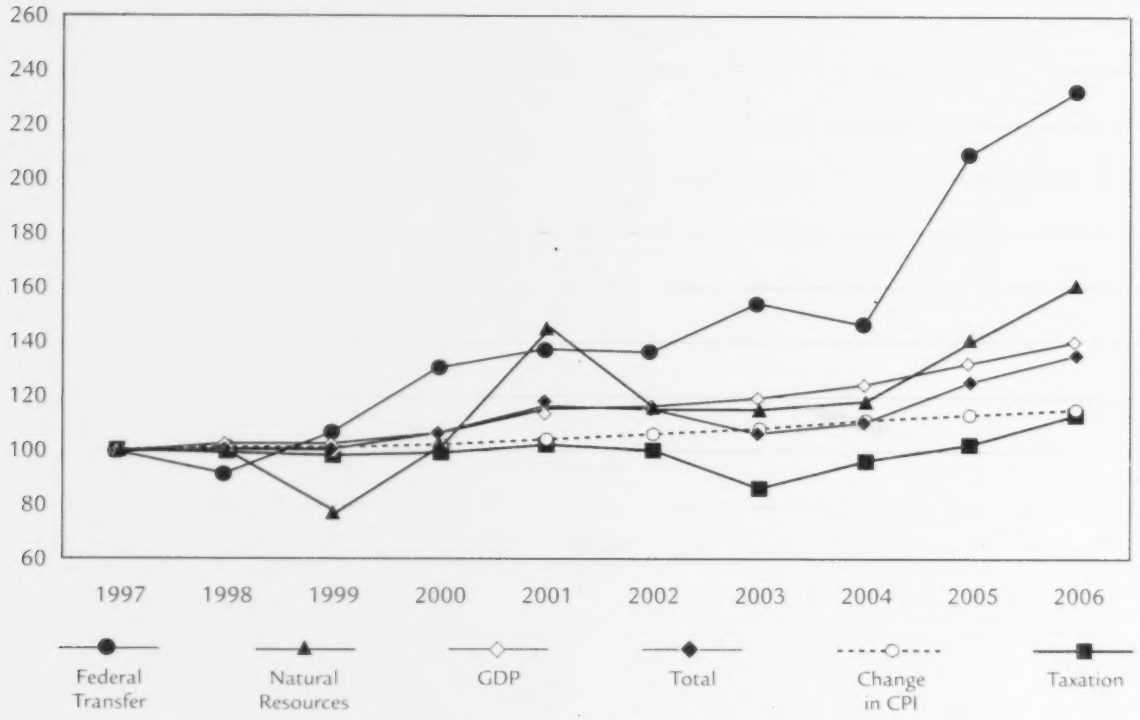
Revenue is often compared with the growth of the overall economy as indicated by the change in the Gross Domestic Product (GDP), because of the common belief that government revenues are related to overall economic health. In Exhibit 5, we also show the change in British Columbia's Consumer Price Index (BCCPI)—a measure of the province's general increase in prices. When making comparisons over long periods of time, it is common practice to include the effect of inflation because, after many years, it can be a major component of the change. The inflation measure in the graph (CPI) allows readers to quickly see if the other measures are keeping pace and to assess how the situation is changing over time.

As indicated in Exhibit 5, not only has total provincial revenue been keeping pace with the growth in the economy, it has also been growing at a rate faster than inflation.

Exhibit 5

Change in Per Capita Revenue, 1997 to 2006

Rate of change in per capita revenue for each of the main sources of revenue and total revenue compared to the rate of change in the Consumer Price Index and the BCCPI (1997 = 100)



Source: Office of the Auditor General of British Columbia

Taxation revenue was also keeping pace with inflation until 2003, when lower personal tax revenue resulted in a significant decline relative to inflation. Since then, however, per capita taxation revenue has increased again and is now at roughly the same level as it was from 1997 to 2001.

Natural resource revenue is analyzed and discussed in more detail in this year's Public Accounts than before. Exhibit 5 illustrates how greatly it has fluctuated over the past 10 years. Federal transfer revenue has more than doubled since the late 1990s. Whether the rate of that growth is sustainable is an important question. How sensitive would government programs—and how vulnerable would British Columbia taxpayers be—to a decline or significant

reversal of rising federal transfers? We discuss this matter further later in Part 1, in the section "CICA Indicators of Financial Condition" (page 36).

Expense Trends

Four general components—health, education, social services and interest—together account for about 82% of government's total expenses. Health expenses, the largest of the three, alone accounts for 39% of the total. Exhibit 6 shows these main expense components for the past 10 years and is the basis for the graph in Exhibit 7.

Exhibit 6

Government Expense, 1997 to 2006

Government expense by main component ($ Billions)

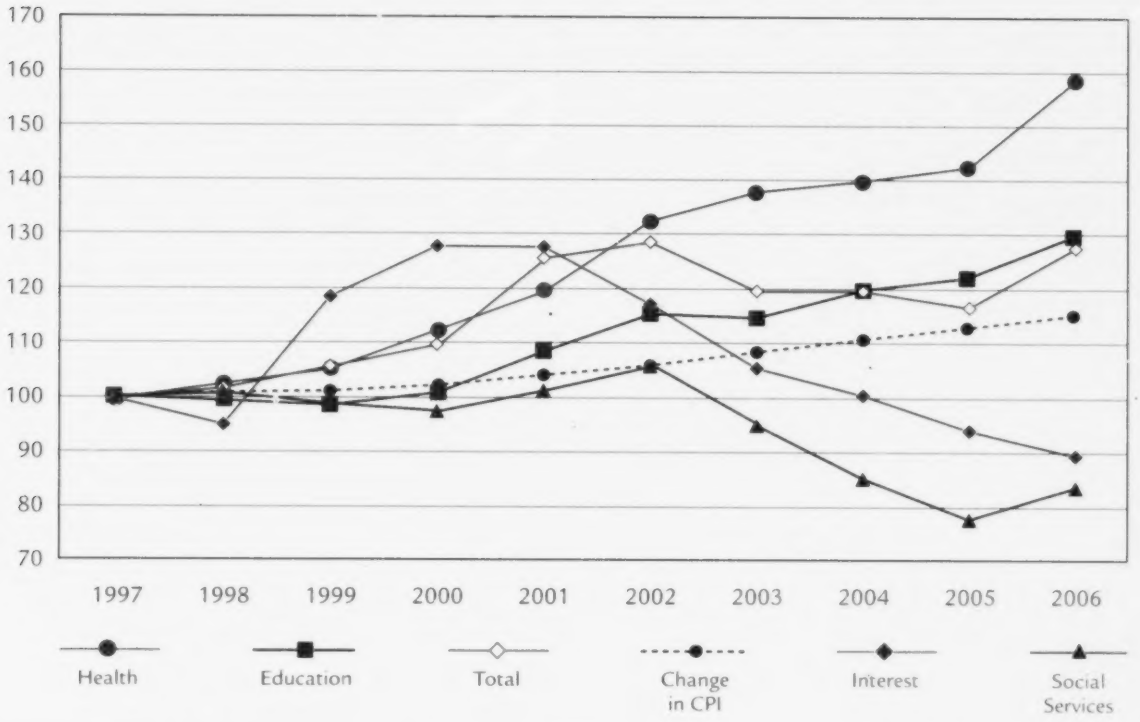
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Health	7.5	7.8	8.1	8.7	9.3	10.4	11.0	11.2	11.5	12.8
Education	6.5	6.5	6.5	6.7	7.3	7.8	7.9	8.3	8.5	9.1
Social Services	3.1	3.2	3.1	3.1	3.2	3.4	3.2	2.8	2.6	2.8
Interest	2.2	2.2	2.8	3.0	3.0	2.8	2.5	2.4	2.3	2.2
Other	5.4	6.1	5.9	5.4	5.7	6.3	6.3	5.7	5.7	6.0
Total	24.7	25.8	26.4	26.9	28.5	30.7	30.9	30.4	30.6	32.9

Source: Office of the Auditor General of British Columbia

Exhibit 7 shows a 10-year trend in the growth of per capita expenses for health, education, social services and interest. Both health and education expenses have grown significantly in the past three years, with the largest increase occurring in 2006. Social services expenses also increased in 2006, reversing a three-year trend of decline. Interest expense has been steadily declining since 2001.

Exhibit 7

Change in Per Capita Expense, 1997 to 2006



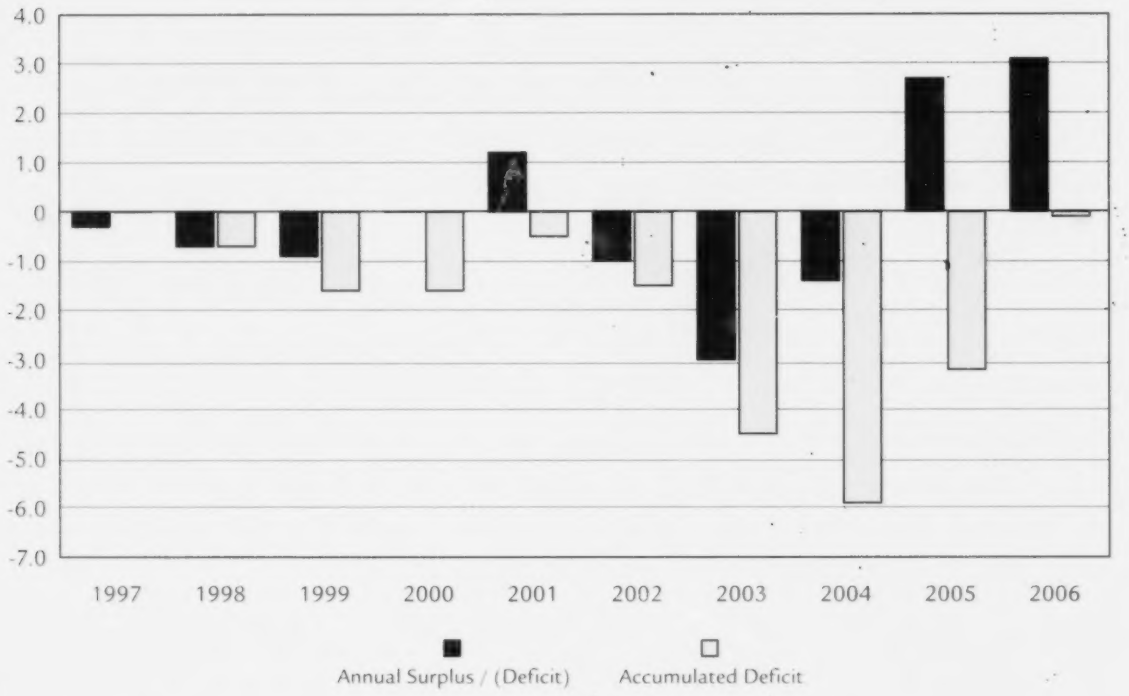
Source: Office of the Auditor General of British Columbia

Surplus/Deficit Trends

Exhibit 8 shows the trend in the annual surplus/deficit and accumulated deficit for the province. A surplus occurs when revenues exceed expenses. A deficit occurs when expenses exceed revenues. The accumulated deficit is the year-to-year accumulation of deficits and surpluses from operations. Funding an accumulated deficit is normally done by the province issuing more debt. This is different from issuing debt for the creation of infrastructure assets (which is sometimes referred to as "good debt").

Exhibit 8

Annual Surplus / (Deficit) and Accumulated Deficit, 1997 to 2006
($ Billions)



Source: Office of the Auditor General of British Columbia

Asset Trends

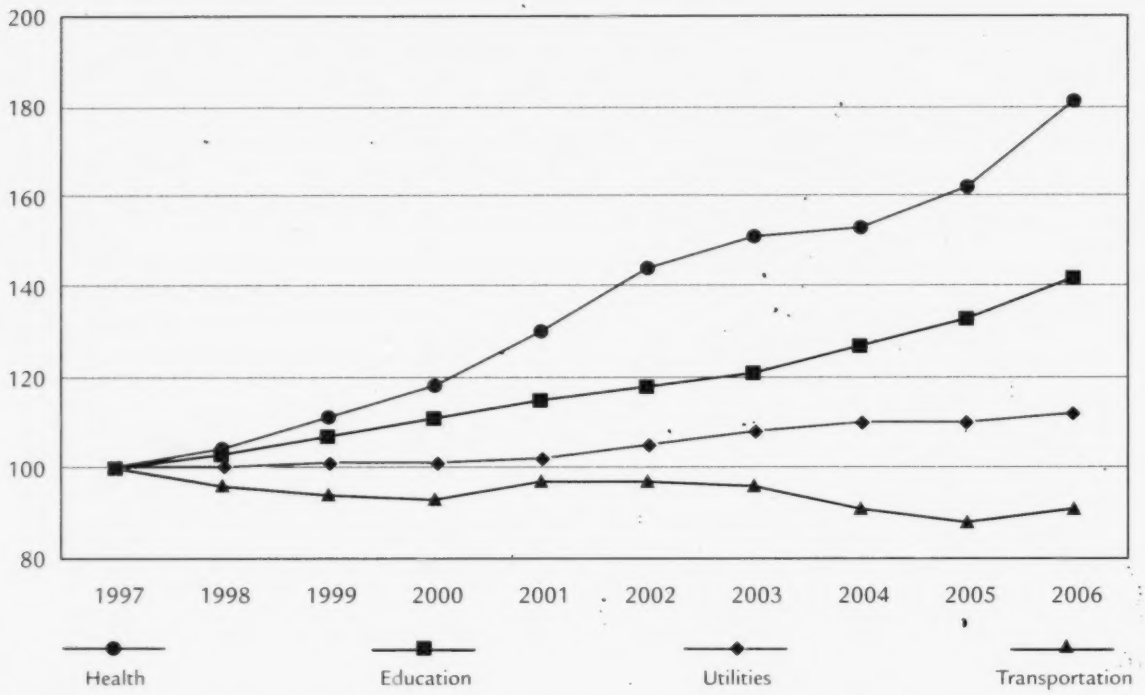
The FSD&A in the 2006 Public Accounts discusses assets in two sections: the first is devoted to financial assets, which are primarily revenue-generating investments; and the second discusses non-financial assets, which are primarily tangible capital assets (infrastructure). Three-year comparative tables are now provided, with a short discussion of the nature of asset changes. Our discussion below focuses on the areas that we feel would benefit most from added analysis.

Exhibit 9 shows the 10-year growth rate of the four major components of tangible capital assets — utilities, education, transportation and health — for the 10 years from 1997 to 2006. Utilities, education and transportation assets account for most of the tangible capital assets. Although healthcare-related assets are a small component of total assets, they show the highest rate of increase. Education assets are growing at a lesser rate, but their impact on overall assets is much more significant because they account for about 27% of the total. The decrease in transportation assets reflects the disposition of BC Rail.

Exhibit 9

Change in Physical Capital Assets, 1997 to 2006

Rate of change in total physical capital assets used for Health, Education, Utilities and Transportation (1997 = 100)



Source: : Office of the Auditor General of British Columbia

[a] The balances are not comparable with the Public Accounts. Where the Public Accounts recognize the investment in BC Hydro as a financial asset, here we look behind the investment to show the impact on utilities infrastructure.

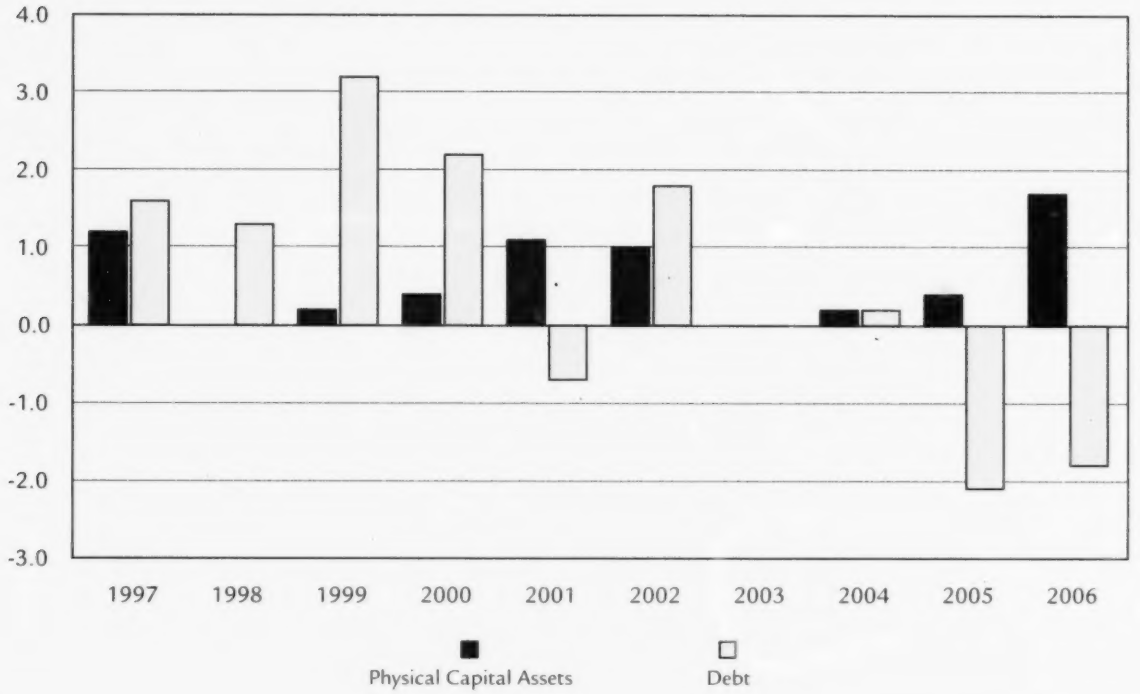
Exhibit 10 compares the increase in net book value of government's total physical capital assets for the past 10 years with the change in total debt for each year, 1997–2006. The graph indicates how much of the change in debt is related to the acquisition of capital assets versus other uses.

Government borrows for a number of different reasons: to finance its operating shortfalls, to build up its stock of capital assets, to finance investment or lending, or to ensure that funds are available when needed.

Exhibit 10

Comparing Changes in Capital Assets and Public Debt, 1997 to 2006

Change in net book value of total physical capital assets compared to change in debt ($ Billions)



Source: Office of the Auditor General of British Columbia

Liability Trends

The analysis and disclosure of liabilities in the Public Accounts are extensive. In addition to the audited Provincial Debt Summary which is presented at the back of the Public Accounts, an analysis and detailed discussion of provincial debt and net liabilities are provided in the FSD&A. However, only a limited trend analysis currently accompanies these.

Exhibit 11 shows the government's net liabilities at the end of each year for the past 10 years.

Exhibit 11

Net Liabilities, 1997 to 2006
($ Billions)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Financial Assets	21.3	22.2	24.3	25.7	25.5	24.8	23.2	24.2	24.8	25.2
Liabilities	41.1	42.6	45.6	48.0	47.9	49.1	50.3	52.9	51.8	50.9
Net Liabilities	(19.8)	(20.4)	(21.3)	(22.3)	(22.4)	(24.3)	(27.1)	(28.7)	(27.0)	(25.7)

Source: Office of the Auditor General of British Columbia

Exhibit 12 compares the rate of change in financial assets, physical capital assets and total liabilities with the change in British Columbia's CPI over the past 10 years. Although fluctuating somewhat more than inflation, assets and liabilities follow a fairly similar trend. In 2005, for the second time in the past 10 years, infrastructure spending increased while debt decreased. This continued in 2006 and is primarily a result of surpluses from operations.

Exhibit 12

Change in Assets and Liabilities, 1997 to 2006

Rate of change in financial assets and total physical capital assets compared to the rate of change in liabilities and BCCPI (1997 = 100)

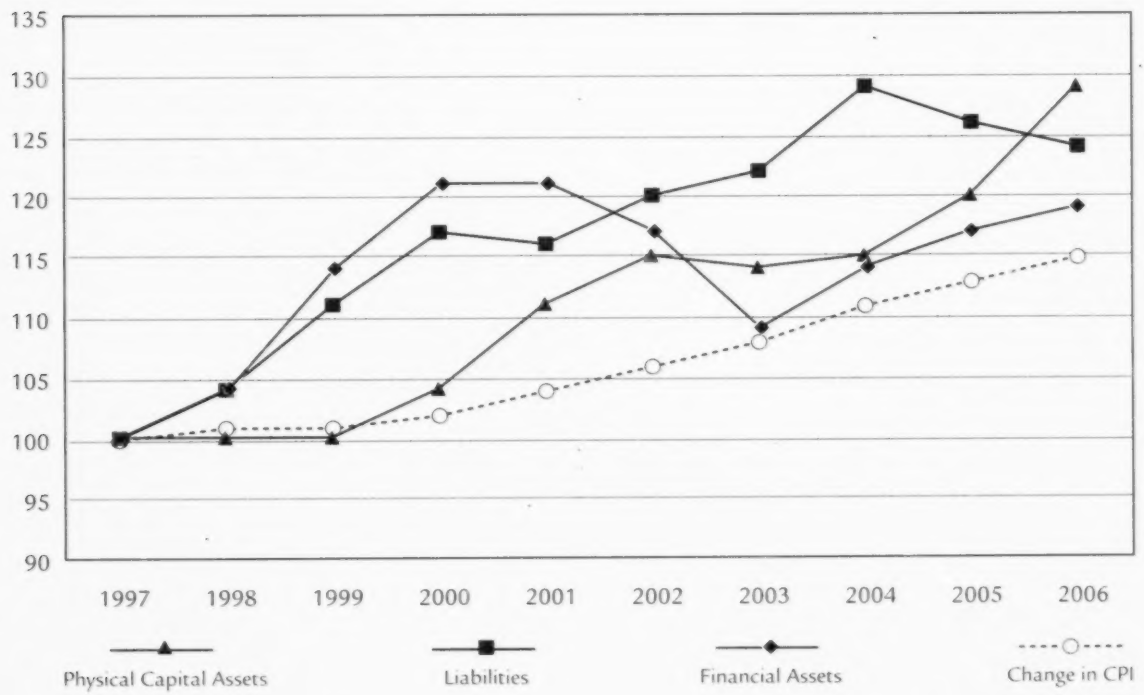
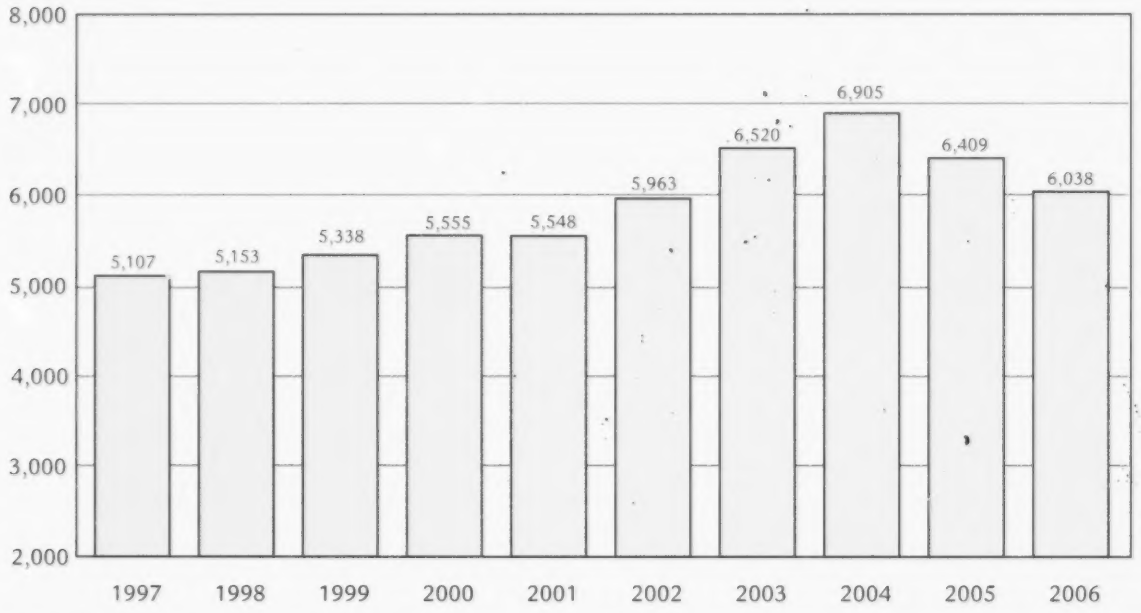


Exhibit 13 shows the province's net liabilities on a per capita basis for the past 10 years. The figures show the amount that each citizen would in theory have to pay to discharge the government's net debt. The net liabilities per capita are 18% greater than they were in 1997, but have fallen by a little over 12% in the past two years.

Exhibit 13

Net Liabilities Per Capita, 1997 to 2006

Net liabilities per capita represents the average financial burden of government's net debt on each citizen of British Columbia ($)



Source: Office of the Auditor General of British Columbia

Our Overall Analysis of Financial Measures and Trends

We continue to encourage government to provide a longer timeframe for trend analysis in the FSD&A. Although the current FSD&A has a three-year trend analysis and government's Financial and Economic Review report already includes a five to eight year trend analysis (depending on the measure). In our view, 10 years is more appropriate because of the nature, size and complexity of government's programs and initiatives.

For example, healthcare infrastructure lasts much longer than even our 10-year timeframe, the majority of the debt is also longer term, and significant revenue and expenditure programs take many years to fully implement. We therefore believe it would be more meaningful and useful to legislators and the public to be able to see the results of operations and state of government's finances over an extended timeframe.

We recommend that government present a long-term trend analysis in the FSD&A, so that it can provide more context for discussing government's financial performance.

Another concern we have is related to risk. As we note at the beginning of this part of our report, one of PSAB's recommended practices for an FSD&A is that it "Include information on significant risks and uncertainties underlying the financial statements, and an outline of the strategies, policies and techniques adopted to manage them."

Underlying the results of operations and the financial position of government are risks that government must continually manage. Risks exist because of an uncertain future or relate to the difficulties in monitoring such variables as public opinion and economic climate.

Although significant risks are identified and discussed in some detail in government's fiscal plan, in the current year's FSD&A, government has included only a very brief discussion which does not fully address how the risks impacted financial results. Uncertainty regarding various elements in the financial statements is disclosed directly in the financial statements in more detail than in prior years; and each section in the FSD&A has some discussion of the nature of significant transactions, trends or balances.

However, we did not find a cohesive discussion of the significant risks and uncertainties underlying the financial statements or of how they were managed in the context of the budget. For example, the budget document details a number of risks to the fiscal plan, such as revenue forecasts, healthcare utilization rates, and federal funding. However, a discussion of the management of these risks is not included in the FSD&A.

We recommend that government expand its FSD&A discussion of material financial risks and uncertainties and the challenges involved in their ongoing management.

Government Business Enterprises

Government business enterprises are Crown corporations that are self-sustaining and do not normally need financial assistance from government general revenue to operate. Examples include BC Hydro, the Insurance Corporation of British Columbia (ICBC) and the BC Lottery Corporation.

In previous years' Reports on Government's Finances, we included the detailed financial position and results of operations for each enterprise in an exhibit. In our report this year, we have treated these enterprises as investments, in keeping with the way they are shown in the Public Accounts and as required by Canadian GAAP (Exhibit 3). This means that their financial positions are summed up into single amounts (described as "Equity in Self-Supported Crown Corporations" in the Public Accounts), known as the "equity method of consolidation".

If the enterprises were fully consolidated, then all of their assets, liabilities, equity, revenues and expenses would be itemized and included in the Public Accounts on a line-by-line basis. Doing so would change the look of the Public Accounts significantly.

There are arguments in favour of both approaches. The international accounting standards community currently favours the "line by line method" of consolidation, integrating all financial statement components of government business enterprises with those of the rest of government. One significant objective of the CICA is to harmonize Canadian and international accounting standards. We expect to see considerable study of this issue in the national and international accounting standards community in the next few years. However, until Canadian GAAP changes, the budget and Public Accounts should still be prepared on the basis of the CICA standards of the day as required by the *Budget Transparency and Accountability Act*.

Notwithstanding the above, this section details the financial position and results of operations of government business enterprises for the past 10 years. We present the information in the same format as we have in our *Monitoring Government's Finances* reports in past years.

Revenue and Expense

Exhibit 14 shows total revenue and expense for government business enterprises over the 10 years, 1997–2006. BC Hydro, ICBC, the BC Liquor Distribution Branch and the BC Lottery Corporation account for most of the revenue and expense. Those of BC Hydro have fluctuated the most because of its activities in buying and selling hydro-electric power on the international market. ICBC's revenue is subject to short-term volatility, affected by investment returns. The BC Lottery Corporation shows the strongest ongoing revenue growth. And the BC Liquor Distribution Branch revenue has been growing at roughly the same rate as its expense.

Exhibit 14

Revenue and Expense of Government Business Enterprises, 1997 to 2006

Detailed Financial Framework for Government Business Enterprises, ($ Millions)

Revenue	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
BC Hydro*	2,514	2,610	3,085	3,387	7,849	6,523	4,530	4,498	4,875	5,598
ICBC	2,624	2,690	2,822	2,966	2,872	2,971	3,023	3,300	3,448	3,790
LDB	1,543	1,598	1,645	1,671	1,732	1,798	1,890	2,004	2,159	2,269
BC Rail	421	427	419	480	497	441	306	374	371	119
BC Lottery Corp	867	942	1,261	1,402	1,483	1,607	1,792	1,890	2,029	2,261
Other	26	94	270	404	24	22	52	36	66	240
Total Revenue	7,995	8,361	9,502	10,310	14,457	13,362	11,593	12,102	12,948	14,277
Expense										
BC Hydro*	2,175	2,202	2,689	2,970	7,403	6,120	4,075	4,400	4,641	5,345
ICBC	2,779	2,676	2,761	2,776	2,886	3,213	2,943	2,998	3,049	3,599
LDB	956	992	1,029	1,054	1,090	1,161	1,236	1,280	1,380	1,469
BC Rail	385	387	392	1,063	503	607	302	323	193	109
BC Lottery Corp	595	652	806	870	921	1,001	1,121	1,162	1,218	1,346
Other	30	126	305	414	32	30	84	34	-91	211
Total Expense	6,920	7,035	7,982	9,147	12,835	12,132	9,761	10,197	10,390	12,079
Net Income	1,075	1,326	1,520	1,163	1,622	1,230	1,832	1,905	2,558	2,198

* Revenue and Expense for BC Hydro have been adjusted to reflect the gross amounts of revenue and expense related to electricity trade derivatives

Source: Office of the Auditor General of British Columbia

In 2006 the net income from all government business enterprises was $2.2 billion, down about 14% from the $2.56 billion in 2005. This is mainly the result of $168 million less net income from BC Rail and $192 million less net income from ICBC.

Assets and Liabilities

Exhibit 15 shows total assets and liabilities for government business enterprises over the 10 years, 1997–2006. About 83% of the equity (total assets less total liabilities) is from two of the enterprises: BC Hydro and ICBC. The growth rate in the total equity of all the enterprises over the past five years has been fairly consistent. In 2005, some of BC Rail's assets were sold, yet overall the equity in self-supported Crown corporations has increased by 22% in the past 10 years.

Exhibit 15

Assets and Liabilities of Government Business Enterprises, 1997 to 2006

Detailed Financial Framework for Government Business Enterprises, ($ Millions)

Assets	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
BC Hydro	11,457	11,319	11,705	11,534	12,306	11,852	11,875	11,849	12,060	12,706
ICBC	5,263	5,630	5,957	5,974	5,909	5,821	6,189	6,899	7,605	8,264
LDB	89	84	91	92	111	125	153	134	154	165
BC Rail	1,659	1,777	1,939	1,401	1,390	1,257	1,130	1,154	522	538
BC Lottery Corp	100	137	164	160	147	160	185	184	288	310
Other	199	437	451	584	381	438	435	496	810	604
Total Assets	18,767	19,384	20,307	19,745	20,244	19,653	19,967	20,715	21,439	22,587
Liabilities										
BC Hydro	9,747	9,424	9,722	9,465	10,196	9,709	9,697	9,936	9,919	10,733
ICBC	5,053	5,406	5,672	5,499	5,428	5,582	5,870	6,281	6,588	7,022
LDB	89	84	91	92	111	125	153	134	154	165
BC Rail	527	608	784	866	864	890	759	740	415	421
BC Lottery Corp	85	95	89	86	104	110	127	113	109	134
Other	96	366	434	478	121	191	122	126	546	247
Total Liabilities	15,597	15,983	16,792	16,486	16,824	16,607	16,728	17,330	17,731	18,722
Equity	3,170	3,401	3,515	3,259	3,420	3,046	3,239	3,385	3,708	3,865

Source: Office of the Auditor General of British Columbia

CICA Indicators of Financial Condition

In 1997 the CICA published a report titled *Indicators of Government Financial Condition*. These indicators provide key relationships, ratios and trends that may assist legislators, decision-makers and the public in evaluating the financial trade-offs related to policy decisions and in better understanding the overall financial condition of government.

The indicators continue to gain wider acceptance by senior governments and market analysts in Canada, helping them monitor the financial condition of the federal and provincial governments with respect to the following key concepts:

Sustainability—the ability of a government to maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy. In other words: Can government continue to raise revenue in order to spend the way it does now?

Flexibility—the degree to which a government can increase financial resources to respond to rising commitments, by either expanding its revenues or by increasing its debt burden. In other words: If government were to increase its spending, how much room is there in the provincial economy for it to pay for the spending by increasing either taxes or debt?

Vulnerability—the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence. In other words: Does government rely too much on revenue from the federal government—revenue that it is unable to control from year to year? Generally, a province can control its taxation policies, but it cannot directly control the annual transfer of funds from the federal government.

For the past five years, we have reported on seven of these indicators of financial condition, showing trends going back to 1997. We have been encouraging government to use the indicators of financial condition and other important financial and economic measures identified in our report in its FSD&A in the Public Accounts.

In our report last year, we commended government for adopting a number of these measures in its Financial and Economic Review report. For 2006, we are again pleased to note that government

has further improved its disclosure of reporting on its financial condition in its Financial and Economic Review report.

We are also pleased that government has, consistent with our advice in this report in prior years, expanded its reporting in its FSD&A on a number of additional financial measures and discussions. Nonetheless, we also did our own analysis in order to provide additional information. After this year, we will review the need for continuing to report on government's financial health through this report, given government's improvements in the FSD&A, and expanded analysis in its Financial and Economic Review report.

Because many of the measures of financial condition have still not been included in the FSD&A, readers are required to move back and forth between the Public Accounts document and the Financial and Economic Review report to gain a complete picture of government's financial condition.

We recommend that government include all relevant indicators of financial condition in its FSD&A, shown over an extended period, to supplement the existing discussion and analysis.

We also noted that one of the measures used in the Financial and Economic Review report and the FSD&A is somewhat different from that recommended by the CICA. The CICA's measure compares government-to-government transfers with own-source revenue. (Government-to-government transfers in this case means those made by the federal government to the province.) The measure used by the British Columbia government compares government-to-government transfers with total revenue. As total revenue includes the transfers, we feel the measure being used by the government does not give as clear a picture as the measure put forward by the CICA.

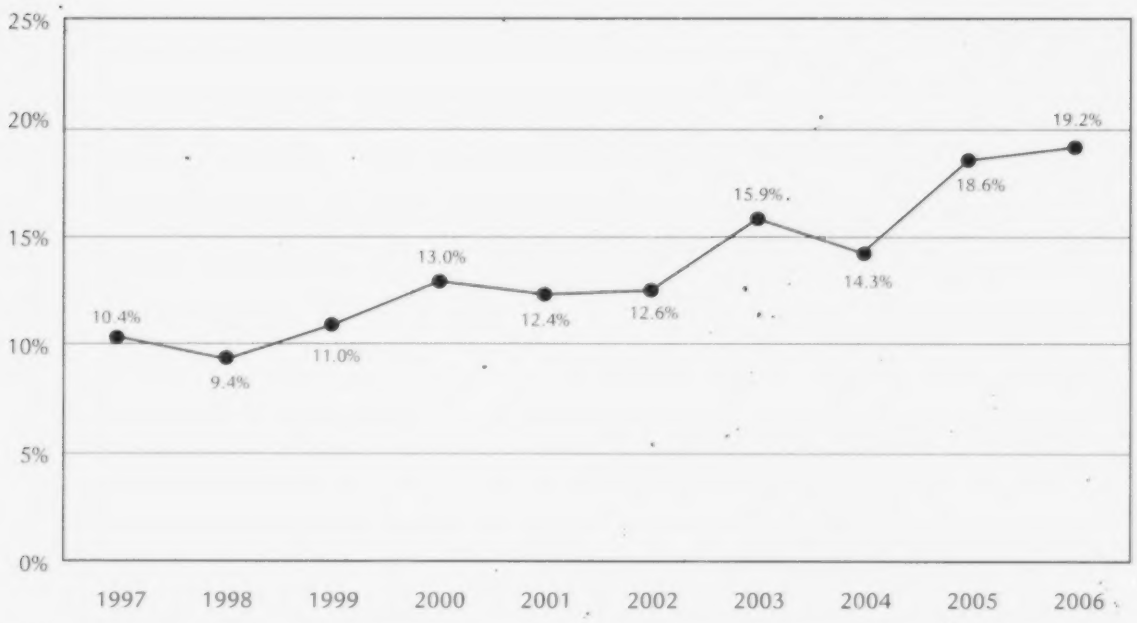
We recommend that government adopt the use of the CICA recommended measure of "government-to-government transfers to own-source revenue" for use in the FSD&A.

Exhibit 16 shows government-to-government transfers relative to own-source revenue as recommended by the CICA.

Exhibit 16

Government-to-Government Transfers to Own-Source Revenue, 1997 to 2006

Federal transfers as a percentage of own-source revenue.



Source: Office of the Auditor General of British Columbia

Part 2:
British Columbia's Financial Condition Compared With Other Canadian Jurisdictions

Part 2: British Columbia's Financial Condition Compared With Other Canadian Jurisdictions

The Big Picture—Where Do We Stand?

Although there are many financial and statistical indicators available today that allow jurisdictions to be compared with one another, comparing them can be problematic. One difficulty is that statistical and economic information between jurisdictions is frequently being revised at different points in time, which can make it hard to ensure comparisons are fair and consistent.

Another common problem is ensuring that what is being compared is prepared on a common basis of measurement. For example, some interjurisdictional measures that rely on audited government financial statements may be prepared using different accounting policies and government structures. Also, government responsibilities are not consistent from one jurisdiction to another. In these cases, additional analysis is required to adjust for these differences and allow comparability.

Much has been done in recent years to try to increase the comparability of financial information from province-to-province. For example new accounting standards require that senior governments adopt GAAP. Comptrollers and Auditors General also continue to collaborate to try to iron out remaining differences and anticipate the potential impacts of emerging issues.

The nature of government programs and structural differences in economic activity also affects province-to-province comparability, and significant analysis must be performed to try to minimize the effect of such differences on the measures chosen.

In this part of the report, we look at the changes in three indicators over the past 10 years. These indicators provide readers with a good understanding of British Columbia's financial performance relative to that of other provinces and the federal government.

GDP Per Capita

Gross domestic product (GDP) per capita is a ratio used to monitor the year-to-year changes in the provincial economy relative to those of other jurisdictions. This information, showing the average output per person for each jurisdiction, is an indicator of the wealth of the province. It is calculated by dividing the nominal GDP for the year by the population.

Part 2: British Columbia's Financial Condition Compared With Other Canadian Jurisdictions

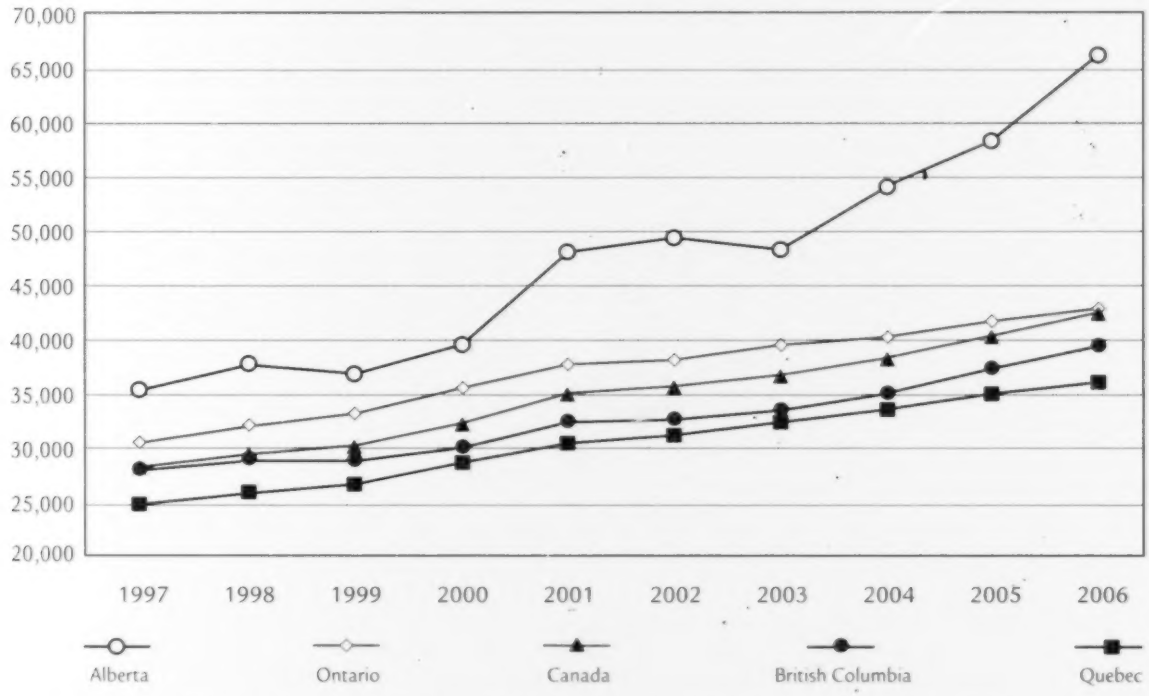
Because many external factors that impact GDP tend to have a similar effect on all Canadian jurisdictions, this ratio is also widely used as an indicator of success of a government's fiscal policies. Although GDP per capita is not a complete indicator of citizens' standard of living, it does provide some idea of the programs and services that a province can afford. In the FSD&A section of the Public Accounts, there is now a discussion of the inflation adjusted growth in GDP, which is a complementary indicator of the overall economic strength of the province.

Exhibit 17 presents the GDP per capita for the four largest provinces—Ontario, Quebec, British Columbia and Alberta—and Canada as a whole, for the 10 fiscal years since 1997. Canada as a whole represents a weighted average GDP per capita for all provinces. Appendix B provides the data for all provinces.

Exhibit 17

Gross Domestic Product (GDP) Per Capita for Canada and four of the Provinces, 1997 to 2006*

A measure of the financial wealth of a jurisdiction ($)



* GDP data is for the calendar year ending in the above fiscal years. Population is as at July 1 of the fiscal year.

Source: Statistics Canada

Part 2: British Columbia's Financial Condition Compared With Other Canadian Jurisdictions

British Columbia's GDP per capita remained at fifth position among the provinces in 2006, behind Alberta, Ontario, Saskatchewan and Newfoundland & Labrador. British Columbia's GDP per capita for 2006 ($39,490) is slightly below the Canadian average ($42,498). Alberta's GDP per capita for 2006 ($66,279), continues to be significantly higher than other provinces, reflecting the positive financial impact of their strong energy sector.

Net Liability to GDP

This ratio is used to monitor the year-to-year fluctuation of a province's shortage of financial assets to meet its liabilities, compared with changes in the economy. It is a ratio used by all jurisdictions in Canada, and therefore is well established and understood by governments and investors alike. Net liabilities can also be thought of as the amount that current and past generations are leaving to future generations of citizens to pay or finance. This ratio makes it easier to compare the net liabilities of one year with those in another year, as well as across different jurisdictions.

The FSD&A now includes this measure, a brief description, and some trend analysis. However, no comparison was made with other provinces.

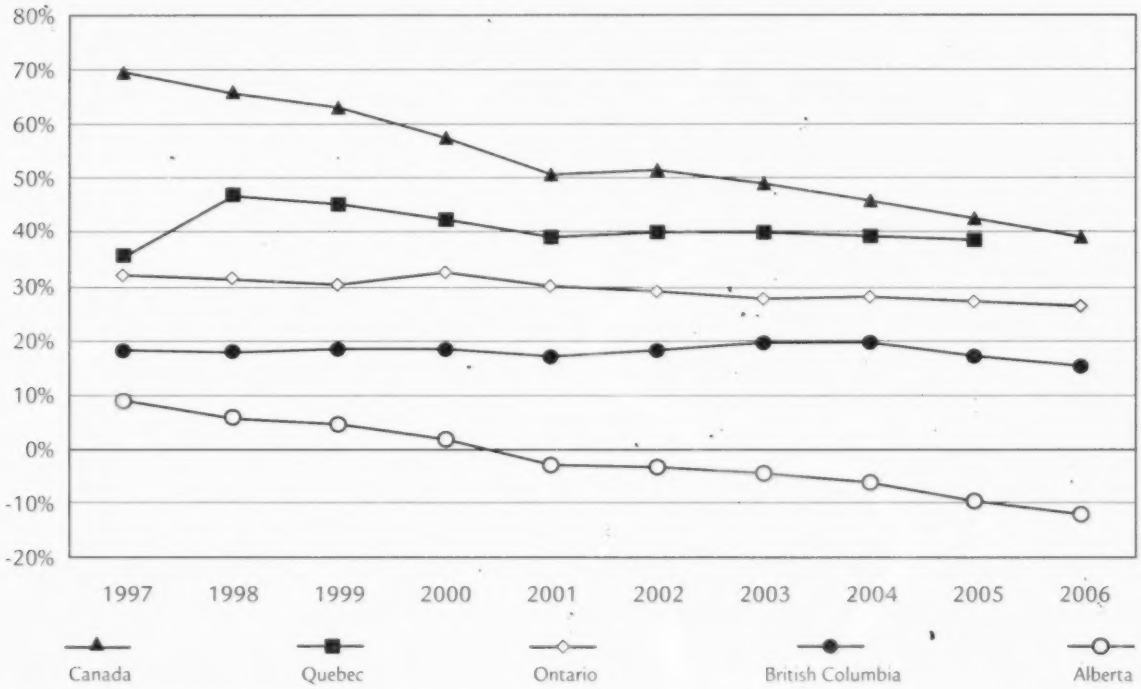
Exhibit 18 presents net liability to GDP for the four largest provinces—Ontario, Quebec, British Columbia and Alberta—and Canada as a whole, for fiscal years since 1997. Appendix C provides the data for all provinces. The net liabilities shown for the other jurisdictions is based on information from their Public Accounts, corrected for any misstatements for which there were audit qualifications.

Part 2: British Columbia's Financial Condition Compared With Other Canadian Jurisdictions

Exhibit 18

Net Liabilities to Gross Domestic Product (GDP) for Canada and four of the Provinces, 1997 to 2006*

The extent to which the economy is able to sustain the demands placed on it by government.



* GDP data is for the calendar year ending in the above fiscal years.

Source: Office of the Auditor General of British Columbia, Statistics Canada

British Columbia ranks second among all jurisdictions with respect to the net liabilities to GDP indicator, behind Alberta, and has maintained this position since 1997. British Columbia's ratio of net liabilities to GDP has remained fairly stable between 1997 and 2004, but with some improvement in the last two years, from 20% in 2004 to 15% in 2006. This recent trend of improvement is consistent across most provinces.

Alberta is the only jurisdiction with a "negative" net liability to GDP, and it has been in that position since 2001. This indicates that Alberta has more financial assets than liabilities.

Part 2: British Columbia's Financial Condition Compared With Other Canadian Jurisdictions

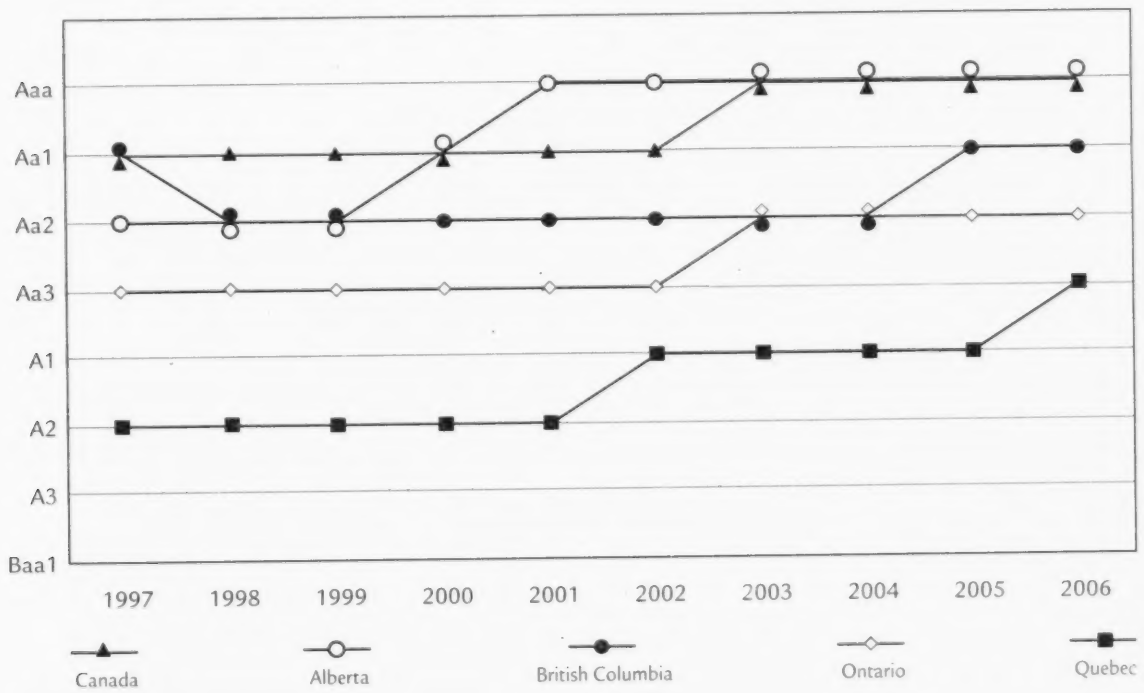
Credit Rating

As a service to lenders, credit rating agencies monitor the changes in provinces' financial condition and publicly report on the jurisdictions through publication of a credit rating. In the opinion of these agencies, British Columbia has been able to keep its high standing in the international financial market. It has the second highest provincial credit rating in Canada, after Alberta. British Columbia's credit rating improved to Aa1 in 2005 from Aa2 (the rating the province had since 1998).

Exhibit 19 compares British Columbia's credit rating by Moody's Investors Service with the ratings for Ontario, Quebec, Alberta and Canada as a whole, for fiscal years since 1997. Appendix D provides the credit ratings for all the provinces.

Exhibit 19

Credit Rating, for Canada and four of the Provinces, 1997 to 2006
Credit ratings as at March 31 of each year



Source: Moody's Investors Service

Part 2: British Columbia's Financial Condition Compared With Other Canadian Jurisdictions

Note: the credit ratings in this table are as at March 31 for each fiscal year. The British Columbia rating of Aa1 for 2006 reflects the rating as at March 31, 2006. In October 2006, prior to the completion of this report, Moody's Investors Services increased the province's rating to Aaa.

Response from the Ministry of Finance

Response from the Ministry of Finance

We appreciate the opportunity to respond to the Auditor General's comments and acknowledgement of the government's continuing progress in adopting best practices in financial reporting.

As the Auditor General notes, the Province of British Columbia continues to be a leader in summary budgeting and financial reporting. The Budget documents are our financial plan; the Overview section and the Provincial Debt Summary within the Public Accounts comment upon and report the actual financial results against that plan. The province, via the Internet, also provides public access to the Financial and Economic Review with its significantly expanded budgetary variance analysis, economic commentary and historical reference information.

These documents provide a full transparent reporting of the province's financial plans and results, consistent with the recommended practice currently under development by standard setting bodies.

The Auditor General has recommended that the government present a long-term trend analysis in the Financial Statement Discussion and Analysis (FSD&A) section of the Public Accounts. He suggests 10 years would provide readers with a more useful historical context of the past and current condition of the government's finances.

The government presented three years of audited trend analysis in the 2005/06 Public Accounts and is planning to present four years of audited trend analysis in the 2006/07 Public Accounts. This trend information is prepared on a basis comparable with all previous years since the province fully adopted generally accepted accounting principles for the public sector in Canada. Additional years of trend analysis will be added as information comes available and is audited by the Auditor General.

The Auditor General has also recommended the government expand its FSD&A discussion of material financial risks and uncertainties and the challenges involved in their ongoing management. We agree that disclosure of risks and uncertainties is important to the users of financial statements and are once again committed to leading senior governments in Canada by developing relevant disclosure to help the users of our financial statements understand the context of the province's financial plans and results.

The Auditor General has recommended that the government include all relevant indicators of financial condition in its FSD&A.

Currently the government provides this information in other documents such as the Financial and Economic Review. As our financial reporting in the Public Accounts continues to evolve in step with emerging best practices in Canada we will continue to evaluate all relevant information, including indicators of financial condition into the FSD&A in a way that provides a comprehensive and accessible picture to the users of our financial statements.

The Auditor General has recommended that the government adopt the CICA measure of "government-to-government transfers to own-source revenue". The government used a very similar measure called government-to-government transfers to total revenue, while the calculation of the ratio differs slightly the result remains the same.

Deciding to change the way this indicator is calculated requires weighing the benefit of continuing to report on a basis consistent with prior years, against the benefit of reporting on a basis that will be consistent with other jurisdictions when they adopt the same recommendations in their financial statements. We will monitor the reporting of other jurisdictions as well as review any new guidance to determine which of these indicators would be appropriate for the next Public Accounts.

Since British Columbia is the first major Canadian jurisdiction to legislate GAAP, and there is such a diversity of reporting across the country, comparing information across jurisdictions for anything more than indicative purposes can be misleading. Other provinces do not have the same organizations nor are they currently including the same entities in their government reporting entity. Therefore, meaningful comparisons are difficult. Until greater consistency is achieved across Canada, at least in terms of the application of accounting guidance, any inter-provincial comparisons should be made cautiously.

Again, we would like to thank the Auditor General for his comments and opportunity to respond to his report.

Appendices

Appendix A: 2005/06 Public Accounts Overview — Financial Statement Discussion and Analysis Report.

Financial Statement Discussion and Analysis Report

1. Financial Highlights

The financial highlights section provides a summary of the key events affecting the financial statements.

The information contained within the Financial Highlights is taken from the Summary Financial Statements on pages 35–81. The budget figures are from pages 3–7 of the *Estimates—Fiscal Year Ending March 31, 2006*, tabled in September 2005, with the exceptions of reclassifications outlined in Note 32, page 70.

Summary Accounts' Surplus

	In Millions			Variance	
	2005/06 Budget	2005/06 Actual	2004/05 Actual	2005/06 Actual to Budget	2005/06 vs 2004/05
	$	$	$	$	$
Taxpayer-supported Programs and Agencies					
Revenue	32,202	33,749	30,805	1,547	2,944
Expense	(32,876)	(32,887)	(30,667)	(11)	(2,220)
Taxpayer-supported net earnings	(674)	862	138	1,536	724
Self-supported Crown corporation net earnings	2,274	2,198	2,558	(76)	(360)
Surplus before forecast allowance	1,600	3,060	2,696	1,460	364
Forecast allowance	(300)			300	0
Surplus for the year	**1,300**	**3,060**	**2,696**	**1,760**	**364**

The province ended the year with a significant surplus of $3,060 million, $1,760 million higher than budget, reflecting robust economic performance, strong commodity prices, higher than anticipated federal transfers and sound financial management on the spending side. Compared to the previous year, the 2005/06 surplus was $364 million higher.

Changes in Actual Results from 2004/05 to 2005/06

	In Millions		
	Revenue	Expense	Surplus
	$	$	$
2004/05 Surplus	**33,363**	**30,667**	**2,696**
Increased income tax revenue – from the 2004 tax year	339		339
Increased income tax revenue – economic growth	620		620
Other taxation revenue increases	553		553
Increased natural gas royalties	482		482
Increased federal transfers	564		564
Other revenue increases	386		386
Decreased commercial crown income	(360)		(360)
Health spending increases		885	(885)
Education and post-secondary spending increases		431	(431)
Other program spending increase		194	(194)
Negotiating framework incentives		710	(710)
Subtotal of changes in actual results	2,584	2,220	364
2005/06 Surplus	**35,947**	**32,887**	3,060
2004/05 Accumulated (Deficit)			(3,184)
2005/06 Accumulated (Deficit)			**(124)**

Financial Statement Discussion and Analysis Report

Revenue increased 8% or $2,584 million from 2004/05 mainly due to the effects on taxation and natural resource revenues of strong economic growth in 2005 and rising energy, metal and mineral prices. These were partly offset by the impacts of tax reductions totaling an estimated $438 million introduced in the September Update. Federal government contributions also increased $564 million from 2004/05 mainly due to British Columbia's share of rising health transfers as a result of the First Ministers' Accord on Health Renewal, partly offset by falling equalization entitlements.

Personal and corporate income tax revenue rose $959 million over the previous year including $339 million of increased prior year adjustments due to improved 2004 tax return results. The remaining $620 million increase reflected the strong growth in personal income in 2005 and British Columbia's share of an increased national corporate income tax base. The growth in personal and business incomes in 2005 combined with strong demand for residential and commercial property led to an increase of $553 million in other taxation revenues – mainly social service and property transfer taxes. The $482 million increase in natural gas royalties was due to increases in price.

These revenue increases were partially offset by a $360 million reduction in commercial Crown corporation net income. The British Columbia Hydro and Power Authority (BC Hydro) results were down $136 million mainly due to higher operating costs; British Columbia Railway Company was $168 million lower than the previous year due to the gain in 2004/05 from the Canadian National Railway Company transaction; and the Insurance Corporation of British Columbia (ICBC) was down $192 million as a result of higher claims costs. These net income reductions were partially offset by $136 million in additional revenue from the British Columbia Liquor Distribution Branch, British Columbia Lottery Corporation and other commercial Crown corporations.

Expenses increased $2,220 (7%) million from 2004/05 primarily due to the $885 million increase in health spending. The increase in health spending reflects implementation of programs funded by the First Ministers' Accord on Health Care Renewal and the 10 year federal government health care funding from the September 2004 agreement. The increase also reflects $710 million in negotiating incentive payments, and an additional $431 million in education spending, primarily due to the implementation of government's post–secondary seat expansion program and additional funding provided to school districts.

Changes from 2005/06 Budget

	In Millions			
	Revenue	Expense	Forecast Allowance	Surplus
	$	$	$	$
Surplus per Budget September 2005	**34,476**	**32,876**	**(300)**	**1,300**
Increased income tax revenue – from the 2004 tax year	278			278
Increased income tax revenue – 2005/06	287			287
Increased property transfer tax revenue	193			193
Other taxation revenue increases	226			226
Increased natural gas royalties	167			167
Increase federal transfers and other changes	320			320
Interest savings		(154)		154
Program savings		(545)		545
Negotiating framework incentives		710		(710)
Unused forecast allowance			300	300
Subtotal of changes in actual results compared to budget	1,471	11	300	1,760
Actual Results	**35,947**	**32,887**	**0**	**3,060**

Revenue was $1,471 (4%) million higher than budget mainly due to the effects of robust economic performance, income growth, and strong commodity prices.

Revenue from personal and corporate income taxes was up $565 million, of which $278 million represented higher prior year adjustments due to better than expected 2004 tax return results. The remaining $287 million improvement reflects, stronger 2005 personal income growth and increased corporate income tax instalment payments in 2005. The remaining increase in taxation revenue is mainly due to the effects on social service and property transfer taxes of increased consumer spending and a strong housing market respectively.

Financial Statement Discussion and Analysis Report

Revenue from natural gas royalties were $167 million higher than budget reflecting higher average prices due to strong North American demand for energy products, partly offset by lower than expected production volumes. Revenue from other sources were up $320 million due to higher transfers from the federal government, increased revenues from investment earnings due to improved cash balances, but were partially offset by lower forests revenue in the coastal forest industry and BC Timber Sales, and a higher Canadian dollar.

Expenses were $11 million higher than budget reflecting the $710 million dollar incentive package provided to bargaining units who negotiated their contracts before their expiry date in 2005/06, partially offset by a $154 million reduction in interest costs and $545 million in other program savings. Further information on the wage settlement incentive payments can be found in Note 31 (page 67).

Net Liabilities and Accumulated Deficit

In accordance with Canadian generally accepted accounting principles, the government's statement of financial position is presented on a net liabilities basis. Net liabilities represent the difference between a government's financial assets and its liabilities and is a measure of the future revenue required to pay for past transactions and events.

	In Millions			Variance	
	2005/06 Budget	2005/06 Actual	2004/05 Actual	2005/06 Actual to Budget	2005/06 vs 2004/05
	$	$	$	$	$
Financial assets	24,616	25,238	24,825	622	413
Less: liabilities	(51,993)	(50,928)	(51,757)	(1,065)	(829)
Net Liabilities	(27,377)	(25,690)	(26,932)	(1,687)	(1,242)
Less: non-financial assets	25,602	25,566	23,748	(36)	1,818
Accumulated deficit	**(1,775)**	**(124)**	**(3,184)**	**(1,651)**	**(3,060)**

The accumulated deficit represents the sum of the current and all prior years' operating results. At March 31, 2006, the accumulated deficit totaled $124 million, $1,651 million lower than budget due to a higher than forecast surplus. The $3,060 million reduction from the previous year reflects the 2005/06 operating surplus.

The $622 million increase in financial assets over budget primarily reflects an increase in cash and temporary investments. Liabilities were $1,065 million under budget and $829 million less than the prior year, primarily due to a reduction in taxpayer-supported debt reflecting the surplus for the year. The reduction in taxpayer-supported debt was partially offset by an increase in accounts payable, primarily due to the accrual of wage settlement incentive payments. Other changes from budget reflect the forecast allowance that was not required, and changes in deferred revenue and self-supported debt.

Non-financial assets typically represent resources that the government can use in the future to provide services, such as tangible capital assets. Non-financial assets were mostly on budget as capital spending and amortization of assets were consistent with plan. Non-financial assets increased significantly over the prior year due to the government's increased capital spending for the post-secondary education, health facilities and transportation sectors.

Total Provincial Debt

When reporting to rating agencies, the province adds to its financial statement debt, all debt guarantees and the debt directly incurred by self-supported Crown corporations reduced by sinking fund assets. This balance is referred to as the total provincial debt.

Total provincial debt at March 31, 2006 was $34,356 million, $1,554 million lower than budget and $1,470 million lower than 2004/05. This includes $27,175 million of taxpayer-supported debt, which was $1,099 million lower than budget and $1,482 million lower than 2004/05.

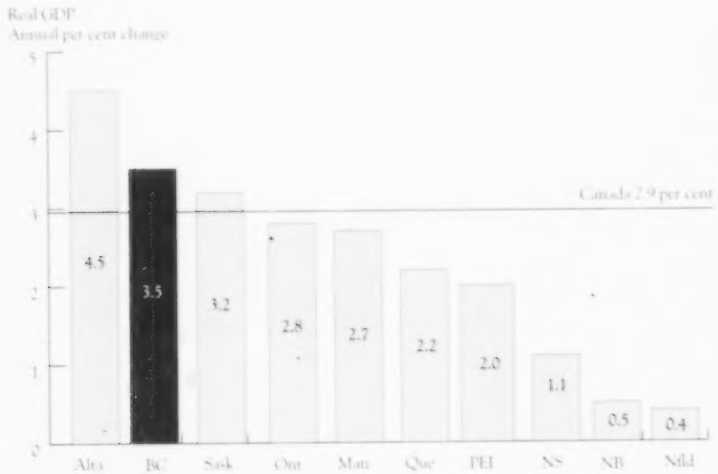
Reflecting the province's fiscal performance, British Columbia has maintained its strong credit rating. In 2005/06, Standard and Poor's upgraded the province to AA+ (2005: AA) and the ratings from Moody's Investors Service Inc. and Dominion Bond Rating Services remained unchanged at Aa1 and AA respectively.

Financial Statement Discussion and Analysis Report

2. Economic Highlights

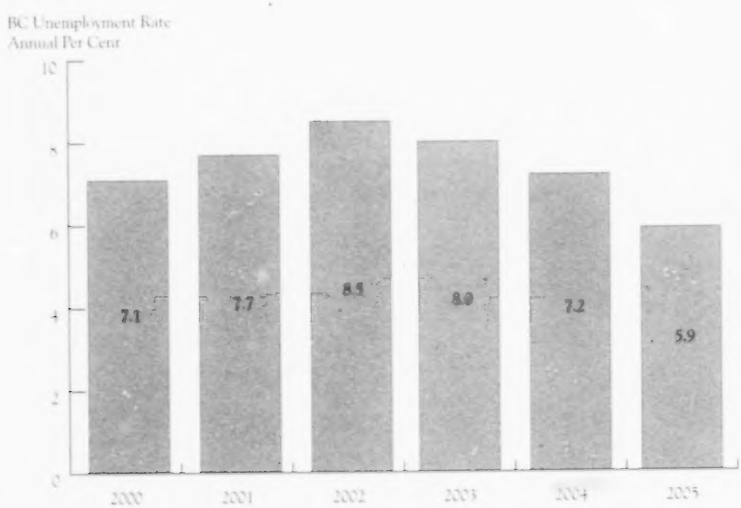
British Columbia's economy grew by 3.5% in 2005, which is the second strongest growth of all the provinces and above the national average of 2.9%, according to preliminary results from Statistics Canada. The estimated 3.5% growth last year was slightly faster than the 3.4% growth rate forecast in the September Budget Update, and slightly lower than the 3.6% pre–budget forecast of the Economic Forecast Council.

Real Gross Domestic Product in 2005



Economic growth in British Columbia was driven by robust domestic activity in 2005. Business investment grew by 8.5%, with growth in both residential construction (8.6%) and machinery and equipment investment (16.7%). Consumer spending, which accounts for about two–thirds of all economic activity in the province, grew by 4.6% in 2005. British Columbia's economic growth was accompanied by a marked drop in the annual unemployment rate to 5.9% (the lowest in 30 years) and strong labour income growth of 6.3%. Despite the continued rise of the Canadian dollar against the US dollar in 2005, total exports of goods and services grew by 2.9%. Imports of goods and services from other countries and other provinces grew by 6.0% in 2005.

Unemployment Rate in 2005



2. Economic Highlights

British Columbia's economy grew by 3.5% in 2005, which is the second strongest growth of all the provinces and above the national average of 2.9% according to preliminary results from Statistics Canada. The estimated 3.5% growth last year was slightly faster than the 3.4% growth rate forecast in the September Budget Update, and slightly lower than in the 3.6% pre-budget forecast of the Economic Forecast Council.

Real Gross Domestic Product in 2005

Economic growth in British Columbia was driven by robust domestic activity in 2005. Business investment grew by 8.5% with growth in both residential construction (8.6%) and machinery and equipment investment (16.7%). Consumer spending, which accounts for about two thirds of all economic activity in the province, grew by 4.0% in 2005. British Columbia's economic growth was accompanied by a marked drop in the annual unemployment rate to 5.0% (the lowest in 30 years) and strong labour income growth of 6.3%. Despite the continued rise of the Canadian dollar against the US dollar in 2005, total exports of goods and services grew by 2.9%. Imports of goods and services from other countries and other provinces grew by 6.0% in 2005.

Unemployment Rate in 2005

Financial Statement Discussion and Analysis Report

3. Financial Performance

The financial performance section includes a more detailed analysis of significant trends relating to the statement of operations, statement of financial position and the provincial debt.

Revenue Analysis

The following analysis helps users understand the government's finances in terms of its revenue sources and to evaluate the revenue–producing capacity of the government.

Revenue by Source

In Millions

	2003/04 Actual $	2004/05 Actual $	2005/06 Actual $
Taxation	13,830	14,917	16,429
Contributions from federal government	3,619	5,222	5,786
Natural resources	3,309	3,973	4,567
Fees and licences	3,531	3,621	3,649
Net earnings of self–supported Crown corporations	1,955	2,558	2,198
Miscellaneous	1,968	2,239	2,370
Investment earnings	950	833	948
Total revenue	**29,162**	**33,363**	**35,947**

In 2005/06, tax revenue increased by $1,512 million (10%) over the prior year and $2,599 million (19%) over 2003/04. Personal income tax, social services tax, property tax and corporate income tax all increased over the previous year. The increase in tax revenue is a result of the stronger economic activity and personal and labour income growth, partially offset by tax reduction measures introduced in the 2005/06 budget.

Contributions from the federal government have increased in 2005/06 by $564 million (11%) from 2004/05 mainly reflecting BC's share of increased funding from the first ministers health accord. Federal contributions rose in 2004/05 by $1,603 million (44%) from 2003/04 reflecting the negative impact of adjustments made in that year.

Natural resources revenues increased in 2005/06 by $594 million from 2004/05. The increase is mostly attributable to an increase in revenue for natural gas royalties offset by lower forestry revenues. Increased revenues also included the effects of higher electricity and metal prices and revenues from the sale of Crown land drilling rights.

Commercial Crown corporation income decreased in 2005/06 by $360 million. The reduction in 2005/06 is primarily due to the comparatively higher results in 2004/05 that included gains resulting from the BC Rail/CN transactions. BC Hydro energy costs, operating costs, and financing charges have increased. ICBC experienced increasingly higher claims costs, and changed its method of recording future claims costs.

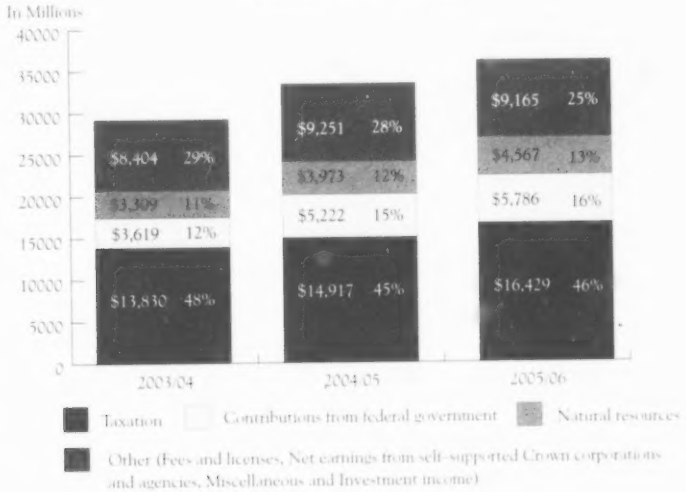
Investment earnings have increased by $115 million from 2004/05 due to increased investments held by the school districts, universities, colleges, institutes and health organizations (SUCH) sector partially due to endowments for universities and overall improvement in financial markets.

Financial Statement Discussion and Analysis Report

Revenue by Source

Revenue by source provides an outline of the primary sources of provincial revenue and changes between sources over time. Revenues are broken down into separate components of taxation; contributions from the federal government; natural resources and other sources, which includes contributions from crown corporations, fees and licenses, and investment income.

2003/04 to 2005/06

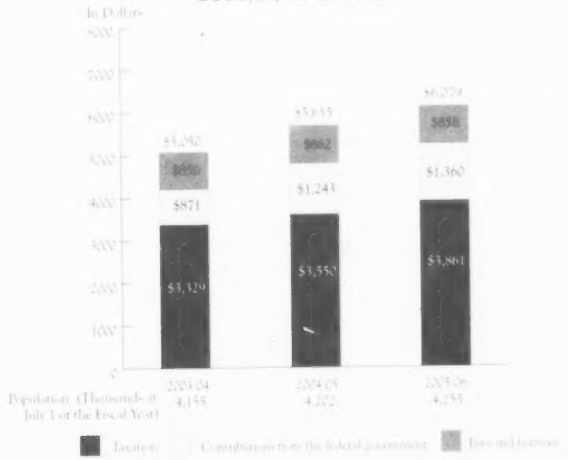


As indicated, the province has experienced a steady growth in revenues over the last three years. This growth is mainly due to provincial economic growth, resulting in an increase in taxation, and natural resources revenues. Federal contributions have also increased as a proportion of total revenues.

Per Capita Revenue

Per capita revenue indicates the amount of revenue received per person in the province for the three main categories of revenue.

2003/04 to 2005/06



Total revenue per capita for these three sources has increased from $5,050 to $6,079 per person (20.4%) 2003/04 to 2005/06. Tax revenue and federal government contributions per capita are increasing at a faster rate than the increase in population, reflecting growth in the economy.

Financial Statement Discussion and Analysis Report

Revenue by Source

Revenue by source provides an outline of the primary sources of provincial revenue and changes between sources over time. Revenues are broken down into separate components of taxation, contributions from the federal government and natural resources, and other sources, which includes contributions from crown corporations, fees and licenses, and investment income.

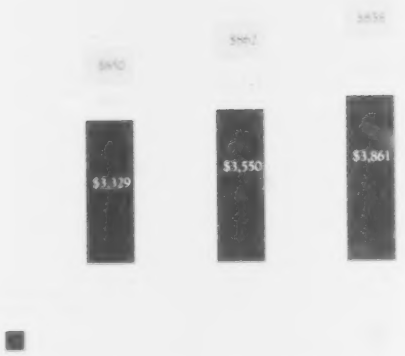
2003-04 to 2005-06

As indicated, the province has experienced steady growth in revenues over the last three years. This growth is mainly due to provincial economic growth, resulting in an increase in taxation and natural resources revenues. Federal contributions have also increased as a proportion of total revenues.

Per Capita Revenue

Per capita revenue indicates the amount of revenue received per person in the province for the three main sources of revenue.

2003-04 to 2005-06



Total revenue per capita for these three sources has increased from $5,650 to $6,679 per person from 2003-04 to 2005-06. Tax revenue and federal government contributions per capita are increasing at a faster rate than the increase in population, reflecting growth in the economy.

Financial Statement Discussion and Analysis Report

Change in Revenue

2003-04 to 2005-06

Natural Resources Revenue

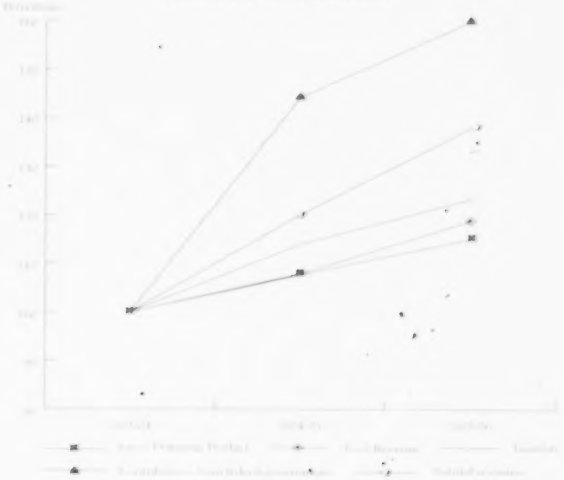
2003-04 to 2005-06

Financial Statement Discussion and Analysis Report

Change in Revenue

A trend analysis of revenue provides users with information about significant changes in revenue over time and between sources, enabling users to evaluate past performance and assess potential implications for the future.

2003/04 to 2005/06

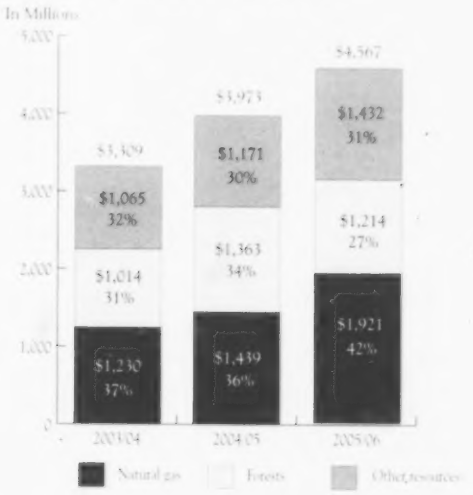


Increases in total revenues and taxation have been consistent with the change in gross domestic product (GDP), federal transfer income and natural resources revenue have exceeded GDP in the past two years.

Natural Resources Revenue

Natural resources revenues are among the most volatile revenue sources for the province mainly due to the effects of market fluctuations on natural gas and forestry revenues.

2003/04 to 2005/06



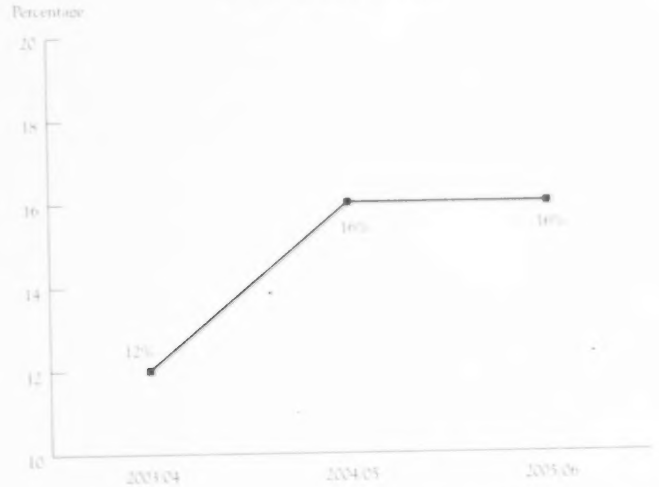
The above shows significant increases in natural resources revenue as a result of the high market demand for energy and minerals. Over the last three years, the make-up of natural resource revenues have changed significantly. Revenues from natural gas have increased proportionally, while revenues from forests have decreased. Other resource revenues, which include petroleum, minerals, energy, and various other revenues, have increased, but remain constant at around 30% of natural resource revenues.

Financial Statement Discussion and Analysis Report

Government–to–Government Transfers to Total Revenue

Government–to–government transfers to total revenue indicates the vulnerability of the province to changes in revenues from the federal government.

2003/04 to 2005/06



The increase in the proportion of government–to–government transfers to total revenue shows a higher dependence on the federal government to fund provincial programs than in 2003/04, mainly due to the increase from the first ministers health accord in 2004/05.

Own–source Revenue to GDP

The ratio of own–source revenue to GDP represents the proportion of income government is taking from the whole provincial economy in the form of taxation, natural resource revenues, user fees and sales (own–source revenue is all revenue except for federal transfers). Own–source revenue to GDP has remained constant at 18% for the last three years. This indicates the government has not needed to increase the proportion received from the economy to fund increases in social spending.

Financial Statement Discussion and Analysis Report

Expense Analysis

The following analysis helps users analyse the impact of the government's spending on the economy, the government's allocation and use of resources, and the cost of government programs.

Expense by Function

In Millions

	2003/04 Actual $	2004/05 Actual $	2005/06 Actual $
Health	11,250	11,529	12,822
Education	8,237	8,512	9,053
Social services	2,753	2,598	2,798
Natural resources and economic development	1,504	1,688	1,638
Transportation	1,119	1,308	1,203
Other	1,075	1,027	1,101
Protection of persons and property	1,363	1,206	1,414
Interest	2,438	2,294	2,182
General government	491	505	676
Total operating expense	30,230	30,667	32,887
Restructuring exit expense	123		
Total expense	30,353	30,667	32,887

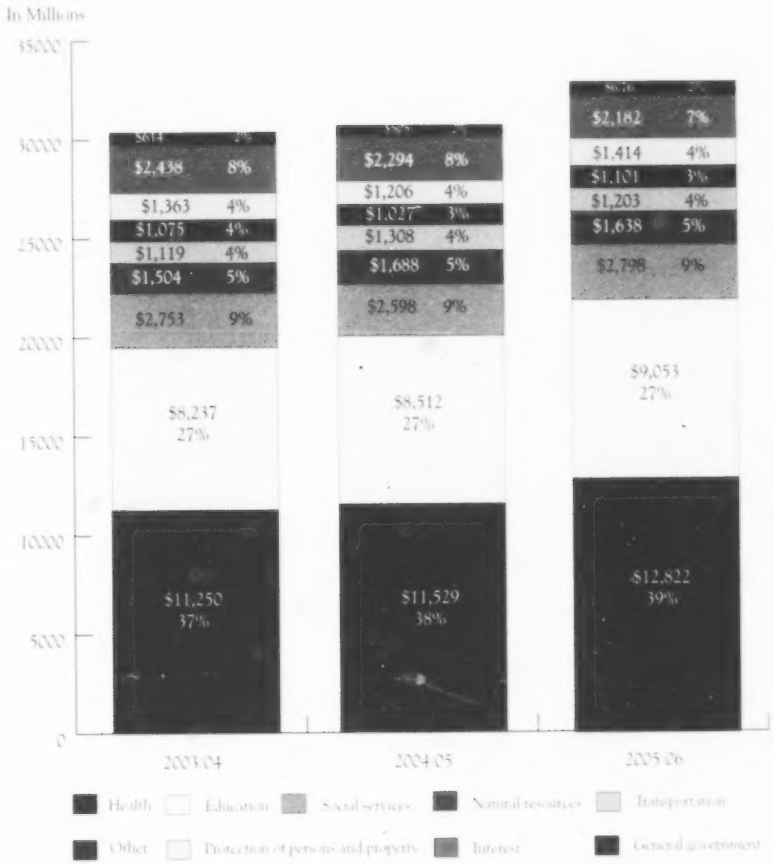
In 2005/06, provincial expense totaled $32,887 million, a $2,220 million (7%) increase over 2004/05 and a $2,534 million (8%) increase over 2003/04. Health spending increased $1,293 million (11%) from 2004/05 with additional expenditures related to surgeries, nurses training, increased staffing levels to provide additional service to a growing and aging population. An increase of $541 (6%) in the education expense reflects the increase in salary and operating costs related to the increase in seat availability in colleges and universities. Social services costs increased $200 million (8%) from 2004/05, but remains consistent with the costs incurred in 2003/04. Increased funding primarily reflects higher income assistance rates for persons with disabilities and funding for childcare.

A detailed breakdown of the impact of the negotiating framework incentive as expensed in each function can be found in Note 31.

Financial Statement Discussion and Analysis Report

Expense by Function

2003/04 to 2005/06

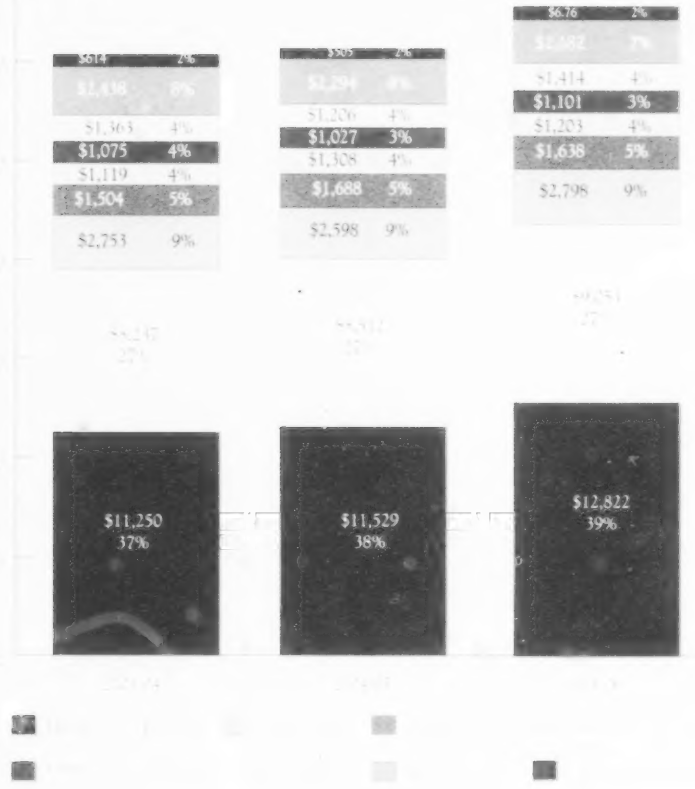


Health, education and social services make up 75% of the province's total operating expense.

The above shows a small spending increase between 2003/04 and 2004/05, while overall spending in 2005/06 increased significantly over 2003/04 and 2004/05. The main increases in spending related to: the increased wages and operating expense in the health sector, which were paid for partially from the funding received from the federal government; increased education funding reflecting post-secondary seat expansion; increased funding to school districts; and the incentive payment made in 2005/06 in relation to the union contract negotiations.

Expense by Function

2003/04 to 2005/06



Health, education and social services make up 75% of the province's total operating expense.

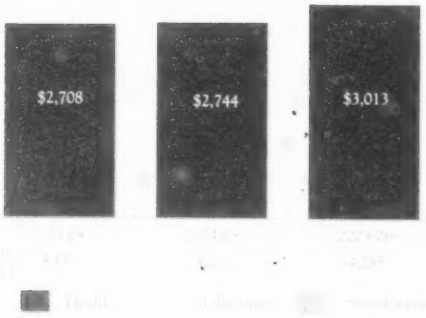
The above shows a small spending increase between 2003/04 and 2004/05, while overall spending in 2005/06 increased significantly over 2003/04 and 2004/05. The main increases in spending related to the increased wages and operating expense in the health sector, which were paid for partially from the funding received from the federal government; increased education funding reflecting post-secondary seat expansion; increased funding to school districts; and the incentive payment made in 2005/06 in relation to the union contract negotiations.

Financial Statement Discussion and Analysis Report

Expenses Per Capita

Expenses per capita indicate the amount expended per person in the province for the three largest categories of provincial expense: health, education and social services.

2003/04 to 2005/06

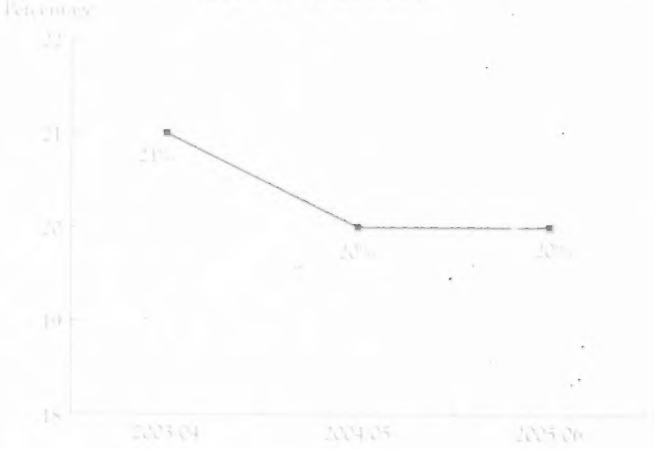


For the three largest areas of spending, expenses per capita have increased from $5,353 to $5,799 (8.3%) between 2003/04 and 2005/06. When combined with other expenses, total expense per capita has increased by 6.3% from 2003/04 to 2005/06. Per capita spending for both education and health continue to gradually increase, while spending on social services has remained relatively constant.

Expense To GDP

The ratio of expense to GDP represents the amount of government spending in relation to the overall provincial economy.

2003/04 to 2005/06

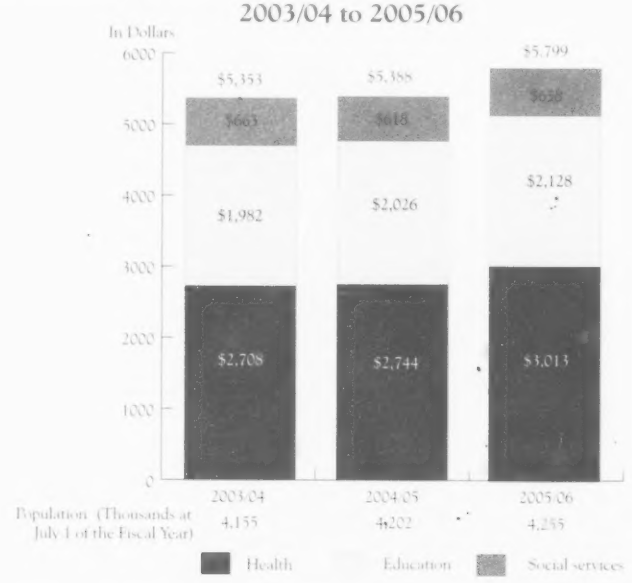


Government spending to GDP decreased slightly in 2004/05 and has remained constant in 2005/06. This indicates that the growth in the economy is able to support additional investment in the province's health, education and social services sectors.

Financial Statement Discussion and Analysis Report

Expenses Per Capita

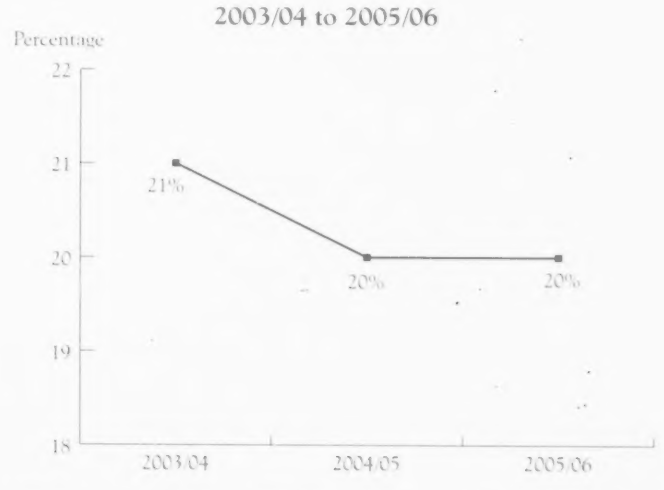
Expenses per capita indicate the amount expended per person in the province for the three largest categories of provincial expense: health, education and social services.



For the three largest areas of spending, expenses per capita have increased from $5,353 to $5,799 (8.3%) between 2003/04 and 2005/06. When combined with other expenses, total expense per capita has increased by 6.3% from 2003/04 to 2005/06. Per capita spending for both education and health continue to gradually increase, while spending on social services has remained relatively constant.

Expense To GDP

The ratio of expense to GDP represents the amount of government spending in relation to the overall provincial economy.



Government spending to GDP decreased slightly in 2004/05 and has remained constant in 2005/06. This indicates that the growth in the economy is able to support additional investment in the province's health, education and social services sectors.

Financial Statement Discussion and Analysis Report

Financial Assets Analysis

Analysis of financial assets provides users with information regarding the amount of resources available to the government that can be converted to cash if required.

	In Millions		
	2003/04 Actual $	2004/05 Actual $	2005/06 Actual $
Cash, cash equivalents and temporary investments	2,690	3,583	3,901
Accounts receivable	2,838	2,649	2,602
Equity in self-supported Crown corporations and agencies	3,020	3,164	3,422
Sinking fund investments	4,619	4,516	4,059
Loans for purchases of assets recoverable from agencies	7,512	6,901	6,916
Other financial assets	3,501	4,012	4,338
Total financial assets	24,180	24,825	25,238

Financial assets trends continue to increase. In 2004/05, financial assets increased by $893 million in cash and temporary investments due to increased federal funding from agreements in healthcare.

Liabilities Analysis

The analysis of liabilities is to provide users with relevant information to assess the provinces ability to meet obligations.

	In Millions		
	2003/04 Actual $	2004/05 Actual $	2005/06 Actual $
Taxpayer-supported debt	33,432	32,032	30,278
Self-supported debt	8,555	7,889	7,758
Total financial statement debt	41,987	39,921	38,036
Accounts payable and other liabilities	6,879	6,655	7,218
Deferred revenue	4,003	5,181	5,674
Total liabilities	52,869	51,757	50,928

Information relating to the government's debt management can be found in more detail in the analysis of the total provincial debt on page 26. Total debt has declined $1,885 million (5%) from 2004/05, $3,951 million (9%) lower than 2003/04. The decline in debt is due to the government's continuing operating surplus and reduced working capital requirements.

Accounts payable and other liabilities were $563 million (8%) higher than 2004/05, primarily due to amounts accrued for the province's negotiating framework incentives.

Deferred revenue has been increasing steadily over the last three years. In 2004/05, the accounting treatment for bid revenues from oil and gas tenure agreements changed, increasing deferred revenue by $1,262 million.

Financial Statement Discussion and Analysis Report

Non–financial Assets Analysis

Analysis of non–financial assets provides users with information relevant in assessing the management of a government's infrastructure and long–term non–financial assets. Management of non–financial assets has a direct impact on the level and quality of services a government is able to provide to its constituents. Non–financial assets typically represent resources that government can use in the future to provide services.

	In Millions		
	2003/04 Actual	2004/05 Actual	2005/06 Actual
	$	$	$
Tangible capital assets	22,270	23,135	24,719
Other assets	539	613	847
Total non–financial assets	**22,809**	**23,748**	**25,566**

At March 31, 2006, non–financial assets totaled $25,566 million which was $1,818 million (8%) higher than 2004/05 and $2,757 million (12%) higher than 2003/04. The increase in non–financial assets from previous year reflects infrastructure spending in health, education and transportation for new buildings and highways.

The majority of the province's non–financial assets reflects capital expenditures for tangible capital assets. The government has increased its investment in tangible capital assets by $1,584 in 2005/06 and $865 in 2004/05 to be able to provide services well into the future. Total investment in tangible capital assets in 2005/06 was $2,970 million, $2,195 million in 2004/05.

Net Liabilities and Accumulated Deficit Analysis

An analysis of net liabilities and accumulated deficit provides users with information relevant in assessing the government's overall financial position. Net liabilities represents the amount repayable by the government before financing future operations.

	In Millions		
	2003/04 Actual	2004/05 Actual	2005/06 Actual
	$	$	$
Financial assets	24,180	24,825	25,238
Less: liabilities	(52,869)	(51,757)	(50,928)
Net liabilities	**(28,689)**	**(26,932)**	**(25,690)**
Less: non–financial assets	22,809	23,748	25,566
Accumulated deficit	**(5,880)**	**(3,184)**	**(124)**

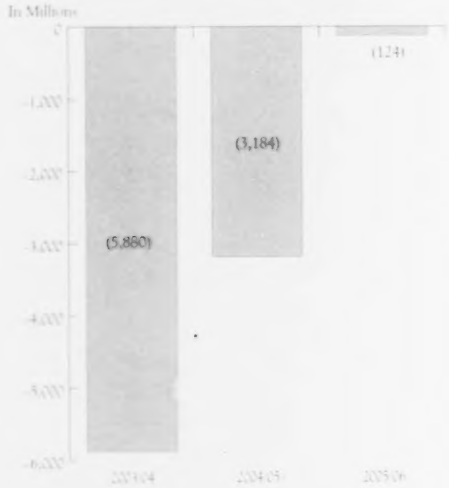
Net liabilities have decreased $1,242 million (5%) in 2005/06 due primarily to paying down the debt. The accumulated deficit totalling $124 million is a $3,060 million (96%) reduction from the previous year and $5,756 million (98%) reduction from 2003/04 reflecting the operating surplus for the past two years. Although the province continues to invest in capital infrastructure, successive surpluses have meant these investments did not require additional borrowing.

Financial Statement Discussion and Analysis Report

Accumulated Deficit

The accumulated deficit represents the sum of the current and all prior years' operating results. As at March 31, 2006 the accumulated deficit totaled $124 million.

2003/04 to 2005/06

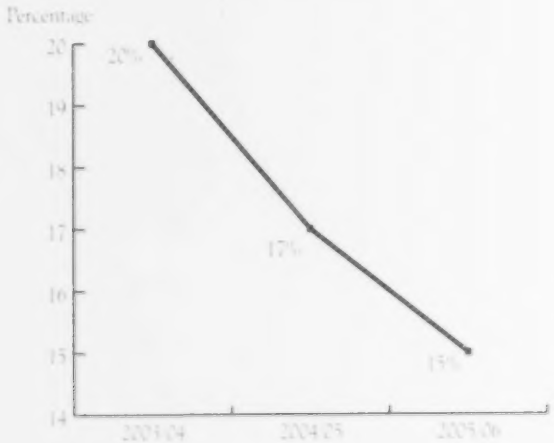


The province has reduced the accumulated deficit by $5,756 million over the last three years as a result of the growing economy and exercising sound fiscal management. The accumulated deficit is now almost eliminated.

Net Liabilities to GDP

The net liabilities to GDP ratio provides an indication of the province's ability to maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.

2003/04 to 2005/06



The government's net liabilities to GDP have declined in both 2004/05 and 2005/06, decreasing the financial burden on the provincial economy and on future taxpayers. The decrease in net liabilities to GDP indicates the province is moving to a greater degree of sustainability.

Financial Statement Discussion and Analysis Report

Accumulated Deficit

The accumulated deficit represents the sum of the current and all prior years' operating results. As at March 31, 2006 the accumulated deficit totaled $124 million.

2003/04 to 2005/06

Net Liabilities to GDP

The net liabilities to GDP ratio provides an indicator of the province's ability to maintain existing programs and meet creditor requirements without increasing the debt burden on the economy.

2003/04 to 2005/06

Financial Statement Discussion and Analysis Report

Change in Net Liabilities

Net liabilities include the surplus (deficit) from operating results less the non-financial assets. Improvement in the net liabilities position provides capacity for increased investment in capital infrastructure.

2003/04 to 2005/06

Net Liabilities per Capita

Net liabilities per capita represents the amount that each citizen would need to pay in order to discharge government's past borrowing and spending practices.

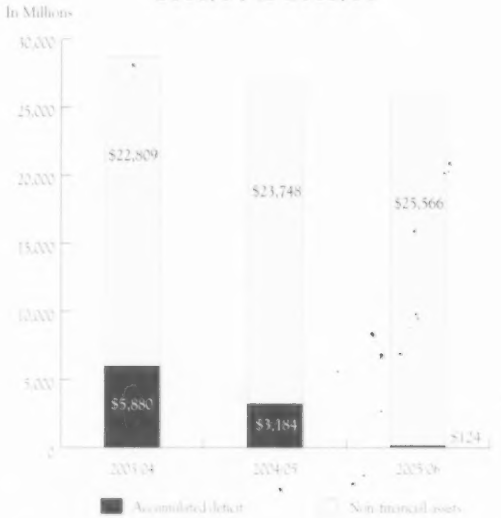
2003/04 to 2005/06

Financial Statement Discussion and Analysis Report

Change in Net Liabilities

Net liabilities include the surplus (deficit) from operating results less the non–financial assets. Improvement in the net liabilities position provides capacity for increased investment in capital infrastructure.

2003/04 to 2005/06

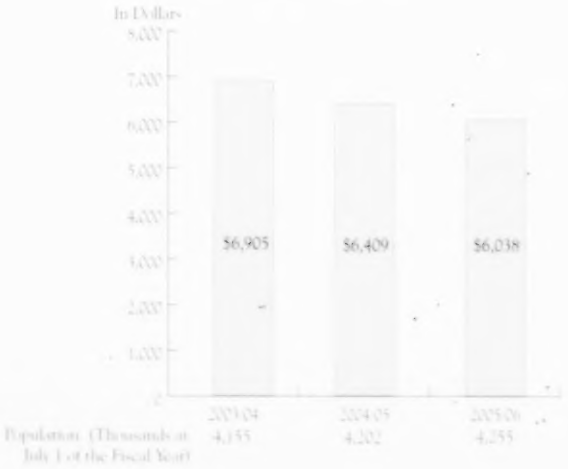


Net liabilities have declined steadily over the last three years. However, the components of net liabilities have changed significantly. Between fiscal years 2003/04 and 2005/06, a greater proportion of the net liabilities have arisen from government's investment in infrastructure projects offset by the decline in the province's accumulated operating deficit.

Net Liabilities per Capita

Net liabilities per capita represents the amount that each citizen would need to pay in order to discharge government's past borrowing and spending practices.

2003/04 to 2005/06



The net amount required to discharge government's past borrowing has dropped from $6,905 million to $6,038 million in 2005/06 due to the decrease in debt and 2% increase in population.

Financial Statement Discussion and Analysis Report

Total Provincial Debt Analysis

Analysis of total provincial debt helps users to assess the extent of long-term liabilities and the government's ability to meet future debt obligations.

In Millions

	2003/04 Actual $	2004/05 Actual $	2005/06 Actual $
Gross debt	41,987	39,921	38,036
Less: sinking funds assets	(4,619)	(4,516)	(4,059)
Third party guarantees and non-guaranteed debt	399	421	379
Total provincial debt	**37,767**	**35,826**	**34,356**

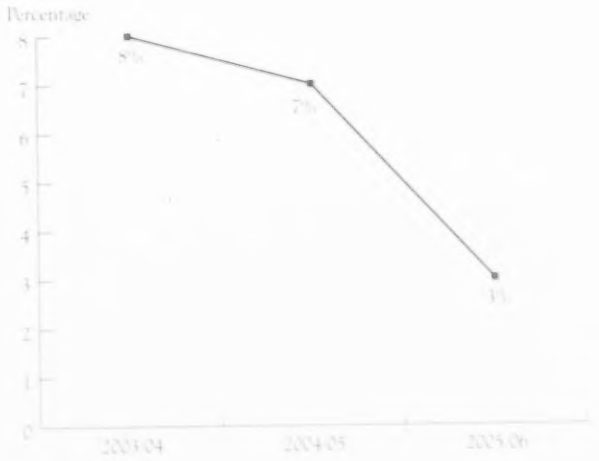
Total provincial debt is $3,680 million lower than the amounts reported in the province's financial statements after deducting sinking funds held to pay down the debt and the inclusion of debt guarantees and non-guaranteed debt.

Total provincial debt decreased by $1,470 million in 2005/06 primarily due to operating surplus reducing the requirement to borrow.

Non-Hedged Foreign Currency Debt to Total Provincial Debt

The ratio of non-hedged foreign currency debt to total provincial debt shows the degree of vulnerability of a government's public debt position to swings in exchange rates.

2003/04 to 2005/06



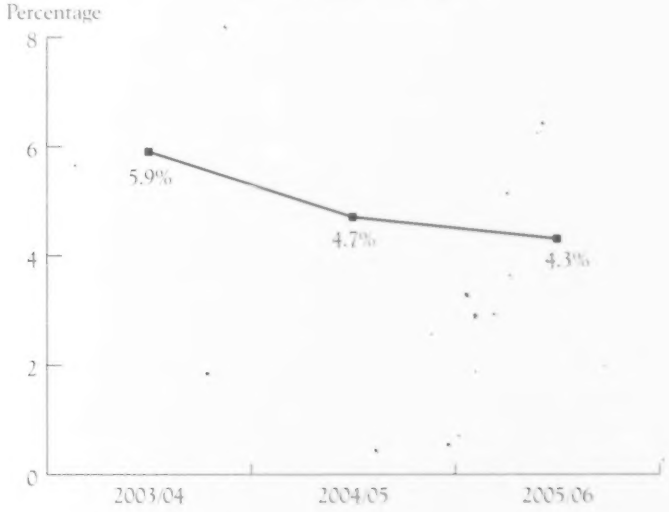
Since 2003/04, the government has reduced its foreign currency debt, thereby reducing the province's vulnerability to changes in the exchange rates.

Financial Statement Discussion and Analysis Report

Public Debt Charges to Revenue (the Interest Bite)

The public debt charges to revenue indicator is often referred to as the "interest bite". This provides users with the percentage of the province's revenue used to pay interest on debt. If a decreasing portion of the provincial revenue is used to pay interest on provincial debt, more money is left to provide government services.

2003/04 to 2005/06



The interest bite has decreased over the last 3 years. In 2005/06, the province spent 4.3 cents of each revenue dollar on interest on the provincial debt.

Strong and Stable Credit

Reflecting the province's strong fiscal performance, British Columbia has maintained its stronger credit rating with all three credit rating agencies. In 2005/06, Standard and Poor's upgraded the province to AA+ (2005: AA) and the ratings from Moody's Investors Service Inc. and Dominion Bond Rating Services remain unchanged at Aa1 and AA respectively.

Credit Ratings June 2006

	Rating Agency[1]		
Province	Moody's Investors Service Inc.	Standard and Poor's	Dominion Bond Rating Service
British Columbia	Aa1	AA+	AA
Alberta	Aaa	AAA	AAA
Saskatchewan	Aa2	AA-	A(high)
Manitoba	Aa2	AA	A(high)
Ontario	Aa2	AA	AA
Quebec	Aa3	A+	A(high)
New Brunswick	Aa3	AA-	A(high)
Nova Scotia	A2	A	A(low)
Prince Edward Island	A1	A	A(low)
Newfoundland	A2	A-	A(low)
Canada	Aaa	AAA	AAA/AA(high)

[1] The rating services assign letter ratings to borrowers. The major categories, in descending order of credit quality, are: AAA, Aaa; AA, Aa; A; BBB, Baa; BB, Ba; and B. The "1", "2", "3", "high", "low", "-", and "+" modifiers show relative standing within the major categories. For example, AA+ exceeds AA.

A more comprehensive overview of provincial debt, including key debt indicators is located on pages 105–117.

Financial Statement Discussion and Analysis Report

4. Risks and Uncertainties

The government's main exposure to risks and uncertainties in regards to government's financial position comes from: economic factors such as commodity prices; outcomes from litigation, arbitration and negotiations with third parties; changes in federal transfers; exposure to interest rate fluctuations, foreign exchange rates and credit risk; and changes in generally accepted accounting principles. Risk management in relation to debt is discussed in Note 19 – Risk Management and Derivative Financial Instruments, on page 57 of the Notes to the Consolidated Summary Financial Statements.

The ratio of GDP per capita for all provinces and Canada, for the fiscal years 1997 to 2006*

(Dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
British Columbia	28,091	28,940	28,932	30,147	32,516	32,737	33,594	35,129	37,421	39,490
Alberta	35,504	37,776	36,959	39,648	48,184	49,489	48,395	54,176	58,397	66,279
Saskatchewan	28,513	28,589	28,829	30,323	33,566	33,124	34,468	36,595	40,228	42,742
Manitoba	25,125	26,218	27,216	27,967	29,682	30,537	31,710	32,472	34,174	35,609
Ontario	30,516	31,996	33,187	35,548	37,719	38,134	39,509	40,242	41,702	42,866
Quebec	24,960	25,952	26,797	28,787	30,573	31,313	32,503	33,676	35,118	36,175
Newfoundland	18,627	19,088	20,506	22,859	26,367	27,163	31,675	34,968	37,566	41,733
New Brunswick	22,134	22,398	23,417	25,354	26,762	27,582	28,191	29,525	30,549	31,552
Nova Scotia	20,991	21,817	22,864	24,688	26,403	27,787	28,977	30,669	31,871	33,533
Prince Edward Island	20,801	20,496	21,759	23,228	24,659	25,099	27,137	28,004	29,173	29,993
Canada	28,278	29,437	30,249	32,313	35,080	35,719	36,749	38,315	40,369	42,498

*GDP data is for the calendar year ending in the above fiscal years. Population is as at July 1 of the fiscal year.

Source: Statistics Canada

Appendix C: Net Liabilities to Gross Domestic Product (GDP)

The ratio of net liabilities to GDP for all provinces and Canada, for the fiscal years 1997 to 2006*

(Percent)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
British Columbia	18.18	17.81	18.45	18.43	17.06	18.22	19.60	19.66	17.13	15.29
Alberta	8.82	5.58	4.54	1.77	-2.97	-3.33	-4.49	-6.16	-9.59	-12.06
Saskatchewan	32.14	30.71	29.93	27.37	24.31	26.29	27.05	25.54	21.22	18.27
Manitoba	29.31	28.36	27.85	30.40	27.61	27.91	28.03	29.21	26.68	25.09
Ontario	32.11	31.32	30.36	32.64	30.06	29.12	27.74	28.09	27.24	26.40
Quebec	35.71	46.63	45.14	42.30	39.06	39.98	39.94	39.24	38.53	na
Newfoundland	69.42	69.04	70.25	66.37	60.60	62.99	64.52	63.36	61.17	na
New Brunswick	32.66	34.04	33.53	35.75	33.85	31.93	31.74	31.42	29.50	na
Nova Scotia	42.82	45.55	48.06	48.71	46.11	46.81	45.15	42.93	41.18	na
Prince Edward Island	35.91	36.40	33.34	31.97	31.05	31.54	31.71	34.15	33.06	na
Canada	69.50	65.67	63.04	57.46	50.66	51.52	48.99	45.85	42.58	39.15

na — not available.

*GDP data is for the calendar year ending in the above fiscal years.

Source: Office of the Auditor General of British Columbia; Statistics Canada

Appendix D: Credit Ratings

Credit rating for all provinces and Canada, as at March 31 for the fiscal years 1997 to 2006

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
British Columbia	Aa1	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa1	Aa1
Alberta	Aa2	Aa2	Aa2	Aa1	Aaa	Aaa	Aaa	Aaa	Aaa	Aaa
Saskatchewan	A3	A3	A2	A2	A1	A1	Aa3	Aa3	Aa3	Aa2
Manitoba	A1	A1	Aa3	Aa3	Aa3	Aa3	Aa2	Aa2	Aa2	Aa2
Ontario	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa2	Aa2	Aa2	Aa2
Quebec	A2	A2	A2	A2	A2	A1	A1	A1	A1	Aa3
Newfoundland	A3	A3	A3	A3	A3	A3	A3	A3	A2	A2
New Brunswick	A1	A1	A1	A1	A1	A1	A1	A1	A1	Aa3
Nova Scotia	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	A3	A3	A3	A2
Prince Edward Island	A3	A3	A3	A3	A3	A3	A2	A2	A2	A1
Canada	Aa1	Aa1	Aa1	Aa1	Aa1	Aa1	Aaa	Aaa	Aaa	Aaa

Source: Moody's Investors Service

Office of the Auditor General: 2006/2007 Reports Issued to Date

Report 1 – April 2006

Strengthening Public Accountability: A Journey on a Road that Never Ends

Report 2 – September 2006

The 2010 Olympic and Paralympic Winter Games: A Review of Estimates Related to the Province's Commitments

Report 3 – November 2006

Audit of Treaty Negotiations in British Columbia: An Assessment of the Effectiveness of British Columbia's Management and Administrative Processes

Report 4 – December 2006

Province of British Columbia Audit Committees: Doing the Right Things

Report 5 – December 2006

Audit of Government's Corporate Accounting System: Part 2

Report 6 – December 2006

Monitoring Government's Finances: Province of British Columbia

Each of these reports can be accessed through our website http://www.bcauditor.com or requested in print from our office.